

Options Paper

Standing charges: domestic retail options

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This options paper considers feedback provided in response to our call for input on Standing Charges. We discuss reducing domestic standing charges by moving some charges to the unit rate (via the operating costs review) and further consider options to increase consumer choice by increasing the diversity in standing charges offered by suppliers. We also lay out longer term considerations relating to the assignment of network costs as a part of a broader review of how electricity and gas system costs are recovered from users.

We expect consumers as a whole to benefit from the changes discussed in this paper, but some consumers' bills would increase, and we are working together with government on how the impact across households in the domestic retail market could be mitigated.

We welcome responses to this options paper. Once the response period is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Contents

Foreword	4
Executive summary	5
1. Introduction	7
Document summary	7
Related publications	7
2. Case for change	8
What makes up standing charges	8
Electricity standing charges have risen and may continue to do so	9
What we heard in response to our standing charges call for input	11
Abolishing standing charges	12
Approach to standing charge reform	14
3. Considerations for shifting operating costs to unit rates	19
Context – cost allocation within the price cap	20
Scope for standing charge reductions	22
Trade-offs and distributional impact	23
4. Increasing consumer choice through tariff diversification	27
Context	27
Case for change	31
Increasing tariff diversity in the fixed term contract market	32
Options to increase tariff diversity in SVTs	34
Smoothing spend for pre-payment customers	36
5. Network and policy cost allocation	39
Context	39
Targeted Charging Review (TCR) and network costs allocation	40
Policy cost allocation	43
Longer term view	43
6. Conclusion and next steps	44
Standing charges options next steps	44
Interrelated workstreams	44
Appendix 1 – Summary of questions	46
Appendix 2 – Draft impact assessment of reducing standing charges in the default tariff cap	47
Scope and approach	47
Summary of findings	48
Impact on consumers	49
Debt impacts	56
Impacts on suppliers	57
Impact on competition and innovation	60
Risks, assumptions, and limitations	63
Wider impacts	64
Appendix 3 – Privacy notice on consultations	66

Foreword

The response to our call for input on standing charges was extraordinary. Over 30,000 people raised their voices, overwhelmingly calling on us to reduce standing charges.

The responses made it clear that standing charges are a significant part of the challenge that consumers face in affording their energy bills. Consumers highlighted how standing charges have prevented them from taking full control of their energy costs because no matter how much they reduce consumption, fixed costs do not reduce. This is felt acutely by customers on pre-payment meters, who may have cut back their use over summer, only to find that new credit is used up paying their accumulated standing charge. This is doubly difficult for those who are also paying off energy debt.

Over the last few years standing charges have increased. The increase has been principally driven by past changes to electricity network charges aimed at making sure that all users make a fair contribution to the fixed cost of the network, whilst avoiding disproportionate impacts on certain low-income groups.

We have explored all the elements of standing charges, and this document lays out the case and potential options for change, considering the risks and benefits. This includes reallocating some operating costs to the unit rate and exploring supplier ability to offer lower standing charge tariffs. We also commit to a review of allocation of network charge and broader system costs to understand whether further changes are needed that would benefit consumers.

Making change is not cost free. The costs that make up standing charges still need to be recovered. For example, to deliver net zero we need to maintain and build our networks at pace, to improve customer service companies need to cover their operational expenses, and policies, such as the Warm Home Discount (WHD), need to be funded.

Within Ofgem's powers, we are not able to remove these costs and therefore these options move costs around the bill, which leads to two challenges:

- Customers on the default tariff cap who use more than average would see increased costs. Many low-income customers could see a noticeable bill rise, which may increase the already significant affordability challenges for this group.
- The price cap as a whole should allow for fair cost recovery to prevent unfair profits and maintain the financial resilience of energy suppliers.

These considerations mean that any changes to the way energy prices are constructed are fundamentally linked to the significant debt and affordability challenges that consumers face. Therefore, we are working closely with government on these issues and will return to stakeholders for further consultation later this year.

Tim Jarvis, Director General

Executive summary

The cost of energy has increased as a significant contributor to the broader cost of living crisis. Energy bills remain a higher proportion of household spending than they did pre-2021, particularly for those on the lowest incomes and, without intervention, this is unlikely to change in the short term.

Standing charges have a role to play in the retail energy market. They help suppliers recover the fixed operational costs of serving each consumer, and fund important network build, upgrade and maintenance costs that are necessary to keep consumers connected and to drive progress towards net zero.

Our call for input on standing charges highlighted that many consumers find them confusing, do not agree that they are needed, and think that they penalise low-income, low-usage customers. Of the 30,000 individuals that responded, 90% stated that standing charges are unfair and almost two-thirds called for their abolition. Abolishing standing charges in the absence of more fundamental market reform risks increasing costs for a significant proportion of consumers, in particular low income, high demand households. Our broader cost allocation review (set out in Chapter 5) will explore the reforms needed to open up a wider range of options on the future of standing charges

We cannot make fixed system costs go away, but we can allocate them differently and work to give customers more choice in how they pay these costs. As an economic regulator, we must work to ensure costs are allocated efficiently and fairly and can allocate costs under the price cap between unit rates, standing charges, or different payment method types. For example, we have already acted to make standing charges for prepayment meter customers the same as those paid by direct debit customers. Despite this, standing charges continue to create challenges for prepayment meter customers, especially those in debt, as well as for many other low-income households. We are therefore focusing on, in particular, supporting customers so that when they put money onto their prepayment meter, it is not used up on unpaid standing charges.

This document sets out further options that could be delivered in the coming months to improve consumer choice in the balance of standing charge and unit rate that is right for them and reduce key components of standing charges.

Through this document, we are seeking views on two core near-term options:

- **Changing the price cap allocation methodology to move some supplier operating costs from the standing charge to the unit rate:** Earlier this year we published our policy consultation on the operating cost review.¹ In it we set out

¹ Ofgem (2024), Operating cost allowances review, <https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowances-review>

that we would be considering a number of options for changes to how supplier operating costs are recovered. This included increasing the allocation of costs to the standing charge or moving all costs to the unit rate. This document outlines a range of options for moving £20 - £100 of operating costs from standing charges to unit rates, but we are seeking views on whether this is sufficient and what mitigants might be required to enable this.

- **Increasing consumer choice by increasing tariff diversity:** We are considering multiple options for how to increase the diversity in standing charge tariff offerings. These include encouraging suppliers to offer tariffs with more diversity in standing charges and considering mandating such offerings if action is not forthcoming. We are also looking at options for prepayment meter customers in how and when they pay standing charges to reduce the impact of seasonal variation, mitigating harm for prepayment meter customers who experience affordability challenges when energy consumption is higher, i.e. in the winter.

Electricity network costs make up the other significant portion of the standing charge. Looking ahead, we need to invest in our electricity networks to reach net zero and reduce our dependency on imported gas. We expect this to result in lower bills overall, but unless we change how these costs are allocated, a higher portion of that bill is likely to be made up of fixed costs and collected through the standing charge. Therefore, we are also committing to look again at the allocation of electricity network costs and some of the decisions we took in the Targeted Charging Review (TCR). These decisions were made in a different economic environment and in the context of different levels of expected network investment, so we will consider whether alternative options, including those previously discounted, would perform better under an updated assessment. This will form part of a broader and more holistic review of how system costs are recovered, with a view to presenting options for reform next year.

While standing charge reform can be an overall progressive measure that improves affordability for those with below average consumption, particularly those that manage their energy bills through rationing energy use, it will not address affordability for all consumers. It would increase bills, potentially worsening affordability challenges, for consumers with above average consumption, which can be for a range of necessary reasons such as low energy efficiency housing and/or reliance on medical equipment. There is a risk that these consumers fall further into debt, causing direct consumer harm and posing challenges to the functioning of the retail market. We are working closely with government on options to address affordability concerns, and should we determine that Ofgem intervention is required, we will consult with stakeholders in due course.

1. Introduction

1.1 Through the call for input, we have heard overwhelmingly from consumers that they want action on standing charges. We recognise that the increased level of standing charges, alongside growing debt and affordability challenges exacerbated by extraordinary market conditions, are increasingly causing consumer harm. In this paper we describe our options to reduce standing charges and increase the diversity in tariffs available to consumers. We make the case to work with government on longer term options to introduce further changes that will deliver positive outcomes for consumers.

Document summary

- 1.1 **Chapter 1** introduces the options paper
- 1.2 **Chapter 2** describes our case for change
- 1.3 **Chapter 3** details options to reduce standing charges in the default tariff cap
- 1.4 **Chapter 4** describes short term options to increase tariff diversity
- 1.5 **Chapter 5** sets out the long-term options to address standing charge concerns
- 1.6 **Chapter 6** concludes the options paper and provides next steps
- 1.7 **Appendix 1** provides a summary of questions asked in this options paper
- 1.8 **Appendix 2** assesses the impact of intervening on standing charges
- 1.9 **Appendix 3** provides the privacy notice on consultations

Related publications

Alongside this document, we have published a summary of responses for the standing charges call for input. [This can be found on our website alongside our call for input.](#)

- 1.10 More broadly, this options paper is impacted by the following documents:
- [Standing charges – call for input](#)
 - [Energy price cap operating cost allowances review](#)
 - [Affordability and debt in the domestic retail market – a Call for Input](#)
 - [Putting consumers first: empowering and protecting energy consumers](#)
 - [Targeted Charging Review: Decision and Impact Assessment](#)

2. Case for change

Section summary

The cost of energy has fallen since the height of the cost-of-living crisis but both standing charges and unit rates are likely to remain above pre-crisis levels. Standing charges play a key role in retail pricing but recent increases are causing affordability and debt challenges for some consumers and these charges are unpopular with consumers. This chapter sets out the case for change for reducing standing charges and the impact on broader affordability and debt challenges.

Questions

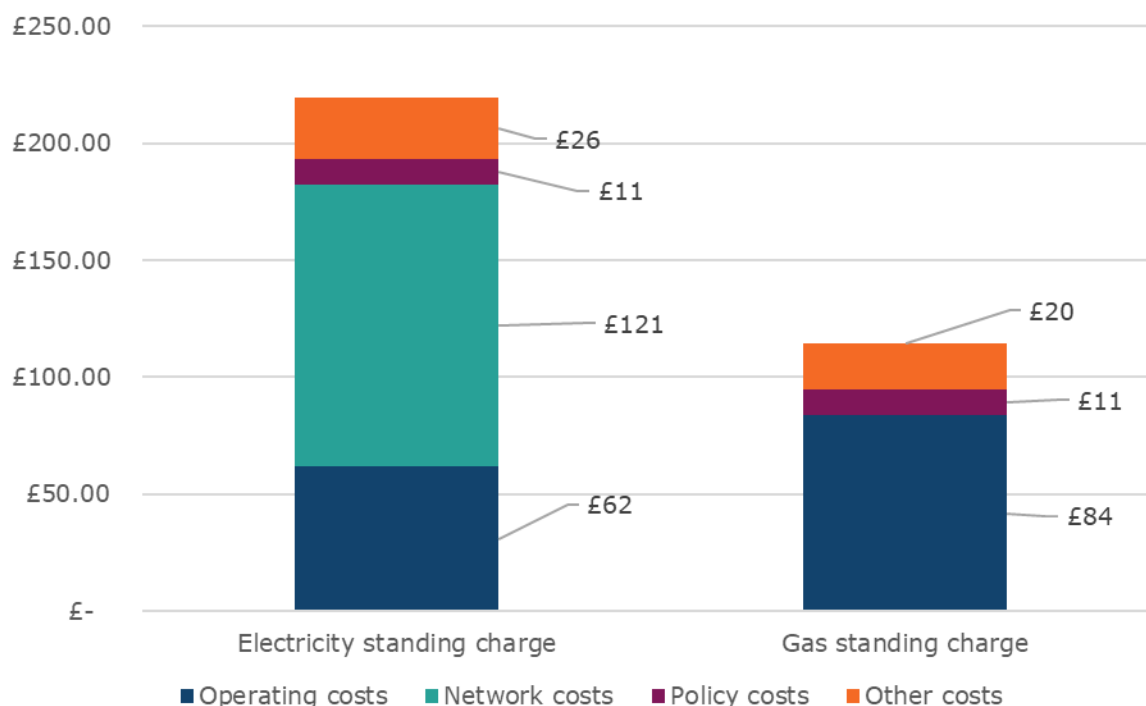
Q1. Do you have any views on our case for change?

What makes up standing charges

- 2.1 Energy tariffs typically consist of two components: standing charges (fixed charges unrelated to energy use) and variable unit rates (charges per unit of energy sold). Standing charges have been a feature of energy bills for as long as there has been a retail energy market. This two-part tariff structure is common in other sectors too, such as the water industry.
- 2.2 Standing charges play a legitimate role in the retail energy market. They recover the 'fixed' costs of the system, by which we mean costs that do not vary by energy use. This includes suppliers' fixed operational costs of serving each consumer, the cost of network upgrades and maintenance necessary to keep all consumers connected and fund the technologies to drive progress towards net zero targets. It also includes the cost of providing Warm Home Discount payments to eligible customers. These costs cannot be avoided; they must be paid for, but there is some optionality in how these costs are recovered.
- 2.3 To an extent, suppliers are free to determine the balance between standing charges and unit rates (including whether their tariffs include a standing charge at all). But on domestic variable tariffs, the total level of the standing charge (and the total tariff including the unit charge) is currently capped by the Default Tariff Cap (the price cap).
- 2.4 We set the price cap to allow an efficient supplier to recover their supply costs and make a reasonable return. Therefore, the balance between the standing charge and the variable unit rate within the price cap is generally determined by whether suppliers face fixed or variable costs for supplying their customers.

2.5 The current standing charge component of the cap includes the cost of electricity networks, metering costs, some policy costs, and some supplier operational costs.

Figure 2.1, Composition of standing charges in the price cap, Jul-Sept 2024



Alternate format: Table of values

Bill component	Electricity Standing Charge	Gas Standing Charge
Operating Costs	£62	£84
Network Costs	£121	£0
Policy Costs	£11	£11
Other Costs ²	£26	£20

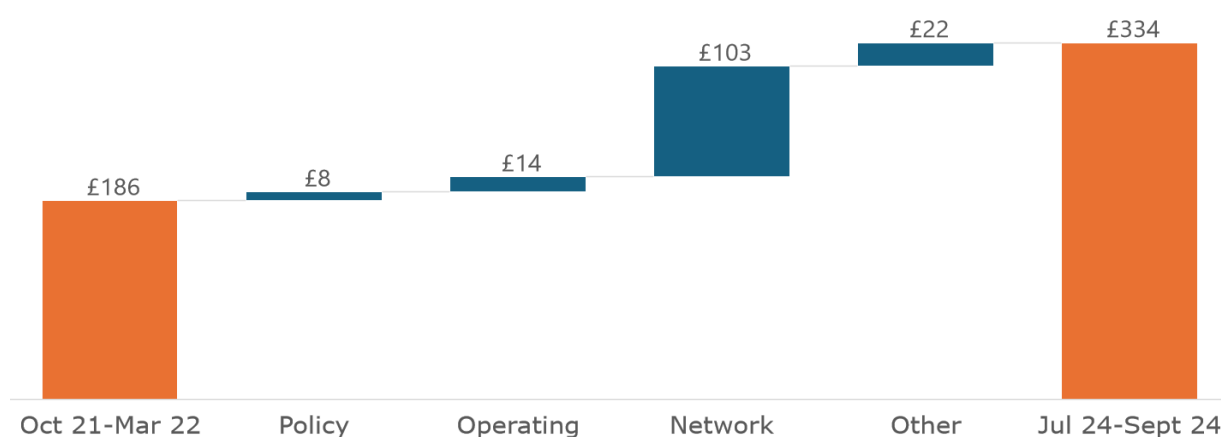
Electricity standing charges have risen and, without intervention, may continue to do so

2.6 The average electricity standing charges for domestic direct debit consumers on standard variable tariffs have risen from £86 per year in October 2021 to £219

² 'Other costs' largely consist of uplifts that apply to both standing charges and unit rates such as VAT, EBIT and headroom. Increases in this costs are driven by underlying increases to the overall price cap level

per year in July 2024.^{3,4} This coincided with sharply rising energy costs and household inflation. The primary cause of increased standing charges on domestic contracts has been the reallocation of electricity network costs following the Targeted Charging Review (TCR) in which we took the decision to move charging of certain types of network costs from a unit cost basis to a fixed basis.⁵ Additionally, more temporary effects like Supplier of Last Resort (SoLR) costs have also had an impact on the increase to standing charges.

Figure 2.2, Change in the standing charge from Oct 21-Mar 22 to Jul-Sep 24



Alternate format: Table of values

Data Point	Value
Total Standing Charge: Oct 21 - Mar 22	£186
Change in policy costs	£8
Change in operating costs	£14
Change in network costs	£103
Change in other costs	£22
Total Standing Charge: Jul 24 - Sept 24	£334

2.7 The TCR sought to ensure that all consumers make a fair contribution to the costs of the networks, and that the structure of charges enabled efficient recovery of residual costs. It aimed to prevent non-domestic consumers from avoiding these fixed costs and therefore delivered a significant benefit to all domestic consumers. As a result, fixed elements of network costs (distribution and transmission “residuals”) are borne by all domestic consumers, without

³ Gas standing charges have remained relatively constant over the same period

⁴ We heard in response to our discussion paper on standing charges that the TCR has driven similar increases to the standing charges that suppliers are offering to non-domestic consumers. This paper focusses on the domestic consumers.

⁵ [Targeted Charging Review: Decision and Impact Assessment | Ofgem](#)

regard for consumption, household income, or consumers' ability to pay, which may be seen as regressive. The same can be said about other fixed elements such as operating costs.

- 2.8 We expect that fixed system costs, such as network costs, will continue to grow, meaning that without reform, standing charges are likely to follow the same upward trajectory. While commodity costs remain uncertain, and subject to volatility, we broadly expect that the transition to a net zero system will drive a reduction in the unit price of energy. This means that, without intervention, standing charges will represent an even greater proportion of bills.

What we heard in response to our standing charges call for input

- 2.9 Our standing charges call for input received over 30,000 individual responses from consumers and other stakeholders. Of these responses, over 90% cited standing charges as unfair and almost two-thirds of consumer responses explicitly called for their abolition. Respondents argued that these charges specifically disadvantaged vulnerable customers, who tend to be low-users and on low-incomes. They further argued that the rationale for how standing charges were recovered was not clear or justified. Specifically, stakeholders considered regional differences in standing charges to be fundamentally unfair.
- 2.10 The extent of the response indicates that we may have reached the point where this perception of inequity is damaging confidence in the market. This could further impact consumer engagement across the energy system, including for the transition to net zero. Our outcomes are better achieved when consumers have confidence that they are being treated fairly.
- 2.11 We received feedback that the current magnitude of standing charges acts as a barrier to many low-income consumers accessing the energy that they need. Many consumer respondents expressed concern that rising standing charges lessen their ability to influence their bills through their behaviour, with some respondents observing that standing charges made up more than half of their total energy bill.
- 2.12 Consumers noted that the fixed nature of standing charges made them feel powerless in the face of rising energy prices; even if they turned off their electrical equipment or heating, they still incurred costs that they considered unacceptable. Many individuals perceived standing charges as the reason they had to resort to drastically reducing consumption to cut their energy

bills. Likewise for customers in debt, the high standing charges made it harder for them to reduce their debt or avoid it increasing further.

- 2.13 We received insight into individual consumer circumstances, such as a single parent (specifically an NHS nurse) who avoided using their heating for a year. They explained that the choice was between warmth or feeding their children.
- 2.14 Further examples explained how the increase in standing charges had impacted consumers' health. One person explained that the increased cost on their energy bill, which is difficult to reduce due to electrically powered medical equipment, meant purchasing lower quality food and using less heating, resulting in detriment to their already challenging physical health.
- 2.15 Going beyond affordability considerations, many consumers said that they felt standing charges discouraged them from making changes to their consumption habits as it would not substantially reduce their energy bills.
- 2.16 While most consumers and consumer groups were supportive of reducing standing charges, some warned of the consequences particularly on low-income high-consumption households, such as those with a chronic illness or disability, who would experience detriment as a result of a higher unit rate.

Abolishing standing charges

- 2.17 Almost two thirds of individual consumers who responded to the call for input asked for us to abolish standing charges altogether. There was a clear message that the current structure of pricing is seen as unfair and the rationale for it is not well understood. We are therefore undertaking a fundamental review of cost allocation that will enable us to explore a broad range of options considering the balance between cost efficiency and fairness (chapter 5). This review will closely link to our work with government looking at more holistic solutions to energy affordability and debt. We are approaching this review with an open mind and will consider whole system reforms that might change the way consumers are charged for their energy use as we move to a cleaner energy system.
- 2.18 In the meantime, we have decided to look at what we can do within the current structures and regulatory framework to bear down on standing charges. In doing so, we recognise that there are constraints to how far we can reduce standing charges in the short term. For example, we have looked at changing the design of the price cap so that it is purely set on a unit rate basis. We have decided not to do this at this stage because of significant concerns around

fairness, cost efficiency, and price incentives for the uptake of low carbon technologies (like EVs and heat pumps). We explore each of these in turn below.

- 2.19 Moving all costs from the standing charge to the unit rate, without other changes to the system, would have significant distributional consequences for consumers, in particular driving up costs for households who have above average energy needs – this includes a number of low-income and vulnerable consumers who are likely to be unable to adjust their usage to manage these additional costs. We set out the distributional impacts of shifting different proportions of costs between the standing charge and unit rate in chapter 3. Our estimates suggest that if we were to abolish standing charges and shift all costs to unit rates roughly half a million low-income households/customers would see a bill increase of c. 10%. This would have negative impacts on those consumers but also on the market as a whole as more people would fall into unmanageable debt.
- 2.20 This could have knock on impacts on supplier resilience in the current market. Recovering costs through the unit rate introduces a risk of under-recovery for suppliers if their consumer base has below average consumption, and for the market as a whole if demand is lower than expected, for example due to warm weather. For costs outside a supplier’s control a risk premium may be deemed necessary to address this uncertainty, increasing immediate costs for all consumers. Furthermore, recovery via unit rates risks some customers avoiding making a cost-reflective contribution to the fixed costs of the system, increasing the burden on those less able to adjust their usage.
- 2.21 Finally, allocating all costs to the electricity unit rate would benefit owners of solar panels but would increase the costs of running heat pumps and electric vehicles (EVs). This approach risks being detrimental to broader net zero ambitions. We have seen this challenge faced by other jurisdictions. For example, California did not include fixed charges on bills but has recently decided to introduce them due to concerns around ability to recover system costs and reduced incentives for the uptake of low carbon technologies.⁶ In doing so, California expects to make home and vehicle electrification more affordable for everyone but has recognised the risks associated with high fixed

⁶ CPUC (2024), Decision addressing assembly bill 205 requirements for electric utilities <https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M531/K686/531686019.PDF>

costs and is seeking to allocate costs in a way that takes account of consumer ability-to-pay (i.e. income-weighted recovery).

- 2.22 There are counter arguments to these considerations. It could be that the higher unit rate (as a result of abolishing standing charges) drives consumption reduction that outweighs the negative impact to net zero price incentives. The higher unit rate could create space for suppliers to compete both under the cap and in the fixed term market, resulting in improved competition, engagement and prices for customers. Suppliers could also be driven to improve their operational efficiency to mitigate the risk that under-recovery of costs (as a result of lower-than-expected demand) impacts their stability.
- 2.23 It is, however, our view that a simple change to the price cap formula at the current time without other, more fundamental changes to the market (such as measures to mitigate both consumer affordability challenges as well as approach to the price cap and supplier resilience) mean that the negative impacts would outweigh any positive benefits. Therefore, as a first step towards reform we are looking at what incremental changes could be made to bear down on the costs in the standing charge and give consumers more choice in the tariffs available to them (chapters 3 and 4). Our more fundamental review of cost allocation will enable us to explore a broader range of options for the longer term (chapter 5). This review will closely link to our work with government looking at more holistic solutions to energy affordability and debt.

Approach to standing charge reform

- 2.24 Recognising that pure abolition could have unintended effects, we have considered how we could reform standing charges to balance the risks with the clear consumer interest in increased control over their energy bills. Standing charge reform can be approached in different ways (and these are not mutually exclusive).

Reforming our approach to setting the notional level of standing charges in the price cap

- 2.25 Our most direct route to deliver change is through shifting some (but not all) cost recovery between the unit rate and the standing charge. We can either do this through the price cap or through the assignment of the underlying costs that contribute to standing charges.

- 2.26 We can mitigate the risk of stability impacts and cost increases by focussing on costs that suppliers are able to control and considering a reduced range for cost transfer. Therefore, we are exploring whether our approach to setting the notional level of the standing charge in the price cap should be reformed to separate more clearly unavoidable pass-through costs (such as network costs) from costs that are within suppliers control (such as aspects of operating costs).
- 2.27 We think that a net customer benefit can be derived from moving £20-£100 from standing charges to unit rates, relative to the current allocation, but welcome stakeholders' views on whether we should go further, and what mitigations should be considered to address issues identified.
- 2.28 Our draft impact assessment shows this would be a progressive change. We estimate that more low-income households would financially benefit, than would lose out, from moving of £20-£100 from standing charges to unit rates. However, the benefits of the winners and costs of the losers are broadly similar in terms of scale. We find that there are there are approximately 3.7 to 3.8 million low-income households that would be classified as winners with an average bill reduction of -£4 to -£19 per household per year. There are approximately 2.3 to 2.4 million low-income households that would be classified as losers with an average bill increase of +£4 to +£18 per household per year. Our income weighted analysis also indicates an annual net positive income-weighted saving to customers of around £140m for our central £60 transfer scenario. We welcome views from stakeholders on whether they would want to see a greater transfer of costs, and what mitigations they would propose for the issues we identify. For further details on our draft impact assessment please refer to Appendix 2.

Increasing Tariff Diversity

- 2.29 Consumers have made it clear to us that they want to be able to make an active choice on what level of standing charge they pay. Therefore, we are considering whether there are actions that we can take to generate the right market conditions and/or commercial incentives to drive more diversity in the standing charges that suppliers are offering to consumers.
- 2.30 We are beginning to see greater variance in standing charge offerings and in chapter 4 we welcome feedback on mechanisms to facilitate greater tariff diversity in competitive offers.

Smoothing spend for prepay customers

- 2.31 We recognise that affordability challenges tied to standing charges can be particularly acute for prepayment meter customers, as they are unable to smooth the seasonal variation in energy costs over the course of a year. This can mean considerable build-up of standing charge debt during the summer months if consumers are not topping up (based on the assumption that they do not need to due to low consumption). This build-up of debt also makes it more challenging for these consumers to get back on supply after periods of self-disconnection, such is the case for many prepayment gas meters during the summer. Therefore, we are considering options for smoothing spend for prepayment meter customers

Longer term reform

- 2.32 In the longer term, we are reviewing how policy and networks costs are allocated, including how we could keep standing charges down given the expected growth in fixed costs such as for electricity network investment. In particular, we are considering decisions made in the TCR that have driven increases to the standing charge. We discuss this further in chapter 5.

Reducing standing charges will not address broader affordability or debt challenges in the domestic retail market

- 2.33 Standing charge reform is an important step towards helping consumers have greater control over their bills and may improve energy affordability, particularly for low consumption users who are vulnerable and at risk of disconnection. But standing charge reform will not directly reduce the total cost of energy faced by consumers as a whole and will not remove the standing charge entirely. Furthermore, in some cases reducing standing charges may increase costs where the customer has high usage. This is of particular concern for those with specific vulnerabilities for whom high consumption is required and for whom standing charge reform would make energy less affordable.
- 2.34 In response to our call for input on debt and affordability, we heard from multiple stakeholders that, despite the magnitude of support made available by government during the recent energy crisis, energy bills remain above an affordable level for many consumers. Consumer groups noted that the number

of households with negative budgets is increasing.⁷ Suppliers expressed similar views noting that income had not kept pace with the cost of living, and that existing support schemes had not kept pace with inflation and are now insufficient.

- 2.35 Consumer groups and charities as well as individual responses noted the increase in energy prices has driven energy to become unaffordable for many consumers. They noted that the rise in energy prices since 2021 has led to a significant increase in household debt levels and some vulnerable consumers with higher levels of consumption that they cannot safely reduce have been especially impacted.
- 2.36 When the energy required to maintain a consumer's health and wellbeing is unaffordable it can lead to unsafe self-rationing and self-disconnection, which has negative health and wellbeing impacts. It can also lead to the unsustainable build-up of debt which may ultimately be socialised, therefore driving up costs for other consumers.⁸ It may ultimately lead to higher healthcare or welfare costs which are borne by society (including other consumers as taxpayers).
- 2.37 Future prices are uncertain, but our analysis suggests high prices could be sustained because there is a continuing risk that commodity costs remain susceptible to global shocks while our system remains dependent on imported gas. Network and policy costs will continue to increase as we transition to a net zero energy system.
- 2.38 Levels of debt tell a similar story and continue to trend upwards. Our data from Q1 2024 shows a total of £3.3bn⁹ (a 53% increase compared to April 2023) in domestic debt and arrears, with our (unpublished) data for Q2 2024 showing further increases. Between April 2023 and April 2024, arrears (households without a repayment plan in place) have grown from around £1.5bn to over £2.5bn (a 72% increase). Our data also shows average household debt and arrears are increasing, with average household debt reaching £900m in Q1 2024. This has increased both for customers with an arrangement to repay the debt, but also for those without any arrangement (which has a higher propensity

⁷ A negative budget is where, after a budgeting session with a money adviser, a household's essential outgoings exceeded their income.

⁸ Such as the temporary adjustment made to the price cap in February 2024 to allow recovery of additional debt related costs: Ofgem (2024), Energy price cap: additional debt costs review decision, <https://www.ofgem.gov.uk/decision/energy-price-cap-additional-debt-costs-review-decision>

⁹ Ofgem Debt and Arrears indicators, <https://www.ofgem.gov.uk/publications/debt-and-arrears-indicators>

to turn into bad debt). This indicates the growth in debt and arrears is being driven by households already behind on their bills. The significant increase in arrears also raises questions around how effective suppliers are at proactively engaging consumers in payment difficulty and what the barriers to accessing support are.

- 2.39 In any case, support will continue to be needed for consumers who struggle to pay, and it will be important for the future of the market to ensure that future volatility does not result in another or ongoing affordability crisis.¹⁰ While the Energy Price Guarantee (EPG) and the Energy Bills Support Scheme (EBSS) worked well in directly reducing consumer bills, as support was provided to all consumers, the schemes were much more expensive than if they had been targeted at those who needed help the most.¹¹
- 2.40 It remains clear that standing charge reform alone is insufficient to address the broader challenge of affordability and debt, and we will publish our next steps on debt in Autumn. We consider that, due to the impact of recent rises in the standing charge, reducing them by a £20-100 could be in consumers' interest, even in the absence of further support, but we will continue to work alongside government to address these challenges. We set out these considerations and seek stakeholder views on the potential mitigations needed at different levels of cost transfer in chapter 3. We also set out short-term options to improve consumer choice through increased tariff diversity in chapter 4.
- 2.41 Over the coming months, we will work closely with government on potential long-term options and solutions for addressing the challenges of standing charges. Chapter 5 below discusses long-term considerations on network costs.

¹⁰ Wholesale markets have experienced record high prices and unprecedented volatility over the past few years, following the economic recovery from the Covid-19 pandemic in 2021, Russia's invasion of Ukraine in February 2022 and Europe's subsequent shift away from Russian gas. As a result, suppliers stopped offering competitive fixed term contracts and most domestic consumers moved onto standard variable default tariffs (SVTs) covered by the price cap. The cap increased, reflecting the higher underlying cost of supplying energy, from pre-crisis levels of around £1,300 per year (in the October 2021 to March 2022 period) to around £4,000 per year (in the period January to March 2023, without government support).

¹¹ NAO (2023), Energy Bills Support, <https://www.nao.org.uk/reports/energy-bills-support-schemes/> 'their universal nature meant that a significant number of households received financial support they did not need'.

3. Considerations for shifting operating costs from standing charges to unit rates

This chapter discusses the advantages and disadvantages of shifting recovery of a portion of operating costs from standing charges to unit rates, including the key trade-offs that would be involved for both consumers and suppliers. This section builds on the considerations we have set out in the May 2024 policy consultation on the operating cost review.

Questions

- Q2. What are your views on the range (£20-£100) of operating costs we are considering shifting from standing charges to unit rates? Should it be higher? Within this range, is there a value you would favour and why?
- Q3. What are your views on the trade-offs and impacts we have identified for consumers and suppliers? Should any of these take more or less significance in our assessment, and are there any important impacts we have not considered?
- Q4. What are the changes required, if any, to the price cap to facilitate a reduction in the level of the operating costs charged through the standing charge?

- 3.1 As discussed in the case for change, we do not consider there to be a case for abolishing standing charges in the price cap due to the detrimental financial impact on low-income, high-using consumers as well as the potential impacts to supplier stability, discussed in our draft impact assessment.
- 3.2 There are, however, some tools at our disposal to improve consumers' ability to control bills by reducing standing charges by a considered amount within the price cap. One of these tools is shifting a portion of supplier operating costs within the cap from standing charges to unit rates.
- 3.3 Although operating costs have remained relatively stable over the last few years across gas and electricity, they form a significant portion of standing charges. Supplier operating costs currently form roughly £135 (c.40%) of annual standing charges (dual fuel). Our May 2024 policy consultation on the operating costs review set out our initial considerations on the balance of costs on the standing charge versus unit rate.¹² This document builds on the consultation and responses we received from stakeholders.

¹² Ofgem (2024), Energy Price Cap: Operating cost allowances review, <https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowances-review>

- 3.4 Moving the entirety of operating costs to the unit rate would have significant distributional consequences and we do not think this would be in the consumer interest as a whole. Nonetheless, we invite comments from stakeholders on what mitigations would be necessary in order to move the entirety of supplier operating costs from the standing charge to the unit rate if this were a desirable approach. Based on the current allowance of roughly £135, we consider that moving between £20 to £100 of operating costs from the standing charge to unit rates could be achieved.¹³

Context – cost allocation within the price cap

- 3.5 The price cap is a cap, rather than a regulated tariff, but the way that Ofgem sets the price cap strongly influences how retail suppliers recover fixed costs. This is particularly relevant in a market where around 85% of consumers are on the default tariff.
- 3.6 The licence includes two specific consumption benchmarks setting maximum charges under the cap: nil-consumption (intended to reflect fixed costs of supply, representing the cost of supplying a consumer with zero usage); and benchmark (which is aligned to 2017 typical customer demand and intended to reflect overall costs of supplying customers). The cap level for all other consumptions is reflected by a straight line between nil and benchmark (and beyond).
- 3.7 What constitutes a fixed cost is not always consistently defined. Some costs, such as network charges, are, from a supplier's perspective, clearly fixed as they are subject to a per consumer charge from network companies. Other charges, particularly relating to operating costs, are not so straightforward. Most of these costs do not scale directly with consumption but there may be some relationship, and suppliers do generally have more control over these. Nor are these costs attributable on a per-customer basis as the marginal cost of an extra customer is negligible. For example, a 'fixed' operating cost might relate to the cost to run a call centre. Generally, the call centre capacity (and therefore cost) is driven by the number of consumers and the rate of consumer calls. Consumers may, however, call more frequently if their usage and therefore bills

¹³ The operating cost review will however set a new overall level of allowance for operating costs within the cap. We will seek to evaluate what an appropriate level of transfer may be following the outcome of the review.

- are higher. Suppliers can, however, try to reduce their call centre costs through efficiencies.
- 3.8 Many businesses in other sectors recover fixed operating costs through variable charges. Suppliers are not obliged to pass fixed costs onto consumers through the standing charge (as opposed to a unit rate), but they can under Ofgem's rules.
- 3.9 In broad terms, supplier operating costs include costs associated with billing, metering, and company premises. Suppliers have greater control over operating costs than they do network and policy costs (e.g. Warm Home Discount) where suppliers are price-takers.
- 3.10 The price cap operating cost allowance is currently made up of three distinct components: the core operating cost allowance, payment method uplift and Smart Metering Net Cost Change (SMNCC). Together, these components allow for the operational costs of a notional efficient supplier.
- 3.11 The core operating cost allowance reflects the operational costs of serving a direct debit consumer and is set using 2017 supplier cost data. We use a stringent approach to benchmarking costs (taking the lower quartile minus £5) to set the allowance to incentivise efficiency improvement, allow suppliers to adequately recover costs, and provide protection to consumers. We update the allowance by indexing it against the Consumer Prices Index including owner occupiers' housing costs (CPIH). This means that the allowance remains the same in real terms but allows for inflationary pressures. The payment method uplift (PMU) reflects the additional costs of serving standard credit and prepayment meter consumers relative to direct debit consumers, and the SMNCC allowance captures the transitional costs of the smart meter rollout. Hence, operating costs and subsequently standing charges have historically varied across different payment methods.
- 3.12 In February 2024, we announced our decision on "levelising" standing charges for prepayment and direct debit consumers from April 2024, with an accompanying reconciliation mechanism. This means that prepayment meter and direct debit consumers pay the same level of standing charges, whereas prior to April 2024, prepayment meter consumers paid higher standing charges due to higher operating costs being associated with them for suppliers. Levelisation is intended to support prepayment meter customers who have proportionally higher levels of vulnerability than direct debit customers.

- 3.13 With prepayment and direct debit standing charge levelisation in place we do not consider it necessary to evaluate different levels of standing charge reduction by payment type in this document. But this policy may itself be affected by a change in standing charges resulting from our operating cost review. Any impacts on levelisation will form part of the review of Phase 1 levelisation due in winter 2025.
- 3.14 When initially setting the price cap in 2018, we noted that supplier practice was to split operating costs between the unit rate and standing charge. We set the initial levels of the cap benchmark in a way that reflected the market split at the time to avoid significantly diverging from the default tariffs available. We therefore included some operating costs in the standing charge and the remainder (around 69%) in the unit rate.
- 3.15 With most customers now on tariffs covered by the price cap, there is no longer a market benchmark to reflect, and so we need to make a judgement on the appropriate balance. Earlier this year we published our policy consultation on the operating cost review. This review looks to update the level and structure of the operating cost allowance within the price cap.

Scope for standing charge reductions

- 3.16 In the May 2024 consultation on the operating costs review we set out that we would be considering several options around the balance of standing charge and unit rate allocation of operating costs. This included increasing the allocation of costs to the standing charge as well as moving all costs to the unit rate.
- 3.17 In response to the consultation several consumer responses noted the unfairness of the standing charge, and that standing charges were too high. In addition to this we received responses from three suppliers that noted their support for moving more costs from the standing charge to the unit rate. Responses to the consultation did not however engage with the level of costs that could reasonably be moved. This options paper provides more detail for stakeholders to respond to as we progress with policy development.
- 3.18 We have assessed the impacts of shifting operating costs to the unit rate in terms of improving consumer control, distributional impacts on consumers, the impact on suppliers and their different average levels of consumption, and the impact on supplier efficiency and ability to finance their operations. Any shift in these costs does not lead to an absolute reduction in costs. This presents us

with a zero sum change where, in financial terms, some consumers will benefit, and other consumers will not. We also need to take supplier distributional impact into consideration. The more operating costs we shift to unit rate, the more low demand customers may not be able to contribute an equal share of fixed costs for suppliers.

- 3.19 We have considered stakeholder views shared in our May 2024 consultation on the operating costs review and following feedback from this options paper we will come forward with more detailed proposal in a statutory consultation. These proposals may include suggesting no changes to the current method of allocating these costs.

Trade-offs and distributional impact

- 3.20 We have assessed the distributional impact on consumers and suppliers of moving operating costs to the unit rate. We considered shifting all of the operating costs to the unit rate, but do not consider this feasible due to the magnitude of the detriment to low-income customers with inflexible high demand and are mindful of the potential risk to supplier resilience. We welcome stakeholder views on any mitigations that could be implemented in order to make this feasible if this were a desirable outcome.
- 3.21 However, we consider that net customer benefit can be derived from moving in the range of £20 to £100, using a ratio of 38:62 for electricity to gas, and present the impacts below. This ratio represents the current proportions of standing charge operating costs between electricity and gas in the price cap and hence we think it is an appropriate ratio to use. We set out some of the key points of our assessment below, with further detail in the draft impact assessment in Appendix 1.

Consumer impacts

- 3.22 Shifting a portion of operating costs onto the unit rate gives households more control over their energy bills by making them more consumption driven. However, this shift will be advantageous to some consumers (“winners”) who have lower consumption or are able to more easily reduce their consumption.

Consumers that have higher than average consumption¹⁴ and are less able to reduce their consumption may face higher bills as a result (“losers”).

- 3.23 We have used Ofgem’s energy consumer archetypes¹⁵ to understand the impacts of an operating cost shift on different groups of consumers. The archetypes were designed to identify and understand different types of energy consumers, including those in vulnerable situations, and to model the impacts of future policy changes. We have adjusted the average electricity and gas demand for each archetype in line with 2022 consumption data. The adjusted consumption by archetype and decile feeds into future calculations.
- 3.24 Our draft impact assessment indicates that there are more low-income households that would win rather than lose with a shift of operating costs from standing charge to unit rate. However, the benefits of the winners and costs of the losers are broadly similar in terms of scale. For the purposes of our analysis, we have defined low income as £19,500¹⁶ and used our 24 archetypes to estimate the share of these low-income users with higher and lower levels of consumption. We find that there are approximately 3.7 to 3.8 million low-income households that would be classified as winners with an average bill reduction of -£4 to -£19 per household per year. There are approximately 2.3 to 2.4 million low-income households that would be classified as losers with an average bill increase of +£4 to +£18 per household per year. For further details on our draft impact assessment please refer to Appendix 1.
- 3.25 We have also considered the effects of standing charges reform on an income-weighted basis.¹⁷ After applying income weights, our analysis shows that low-income households (particularly archetypes A1 – A3) realise the largest gains. Higher income archetypes tend to see smaller income-weighted gains from this policy. Summing all of the impacts across the consumer archetypes we find a net positive income-weighted saving to customers of c.£140m for our central £60 transfer scenario, implying that standing charges reform is more progressive than the status quo.

¹⁴ For the purposes of our analysis we have assumed average consumption is in line with benchmark consumption within the price cap i.e. 3100kWh for electricity and 12,000kWh for gas.

¹⁵ Ofgem (2024), Consumer archetypes update 2024, https://www.ofgem.gov.uk/sites/default/files/2024-02/Ofgem_archetypes_update_2024_FinalReport_v4.1.3.pdf

¹⁶ We have calculated this based on median household disposable income (£32,300) in the UK for FYE 2022 as published by the office for national statistics. We have taken 60% of median income as our definition of low income, in line with the ONS definition of the poverty line.

¹⁷ Income-weighted analysis considers how a £1 cost or saving has a different marginal utility depending on a household’s income. For more details see Appendix 2.

- 3.26 We are particularly concerned about the impacts these shifts may have on vulnerable households, especially those on low income with inflexible high demand. Lower income households do not necessarily have lower energy consumption, particularly when they are living in poorly insulated homes, or have medical needs that lead to increased energy use.
- 3.27 To demonstrate how the impacts vary across different types of consumers, we have considered seven case studies in our draft impact assessment. Each case study covers a particular consumer type with different levels of consumption between gas and electricity. Table A7 in the draft impact assessment describes each case study and the dual fuel bill impact of shifting £20 to £100 of operating costs from standing charge to unit rate, for an average direct debit consumer.
- 3.28 The analysis demonstrates that households with lower-than-average consumption (e.g. small flat with low consumption) will benefit from the transfer of a portion of operating costs from standing charge to unit rate, while households with higher-than-average consumption (e.g. those with primarily electric heating or poor energy efficiency) will see their bills increase.
- 3.29 Our analysis demonstrates that there are benefits to low-income customers as a whole and the added ability for all customers to have a greater degree of control over their bills. Despite this we recognise that there will be a group of lower-income customers who are negatively affected, as they have higher use than typical users. Our archetypes analysis, which is based on the Living Costs and Foods Survey (LCFS), does not in itself identify the size of this group, which cannot be directly measured without the use of enhanced data matching of high-usage customers with markers of vulnerability. However, an initial review suggests there is likely to be an important subgroup of low-income users that use more than 50% higher than typical consumption values. These users could be particularly adversely affected by a change to standing charges.
- 3.30 We will consider options for how to better identify the size of this group and work with government to consider whether those on low incomes, who might be adversely affected by changes to standing charges, require additional protection. We welcome views from stakeholders on what, if any, additional consumer protections are required to support these customers.

Supplier impacts

- 3.31 In addition to the impacts on consumers, moving operating costs from standing charges to unit rates will have an effect on suppliers. The effect will be different between suppliers with customer bases that have significantly different energy consumption levels. For example, suppliers with higher-than-average consumption per customer may over-recover fixed costs if volumetric unit rates rise. Conversely, suppliers with below average consumption per customer may be less certain that fixed costs would be recovered.
- 3.32 Supplier financeability (the need for suppliers that operate efficiently to be able to finance activities authorised by their supply licence) is something we must consider when setting price cap conditions. Our overriding duty is to protect customers who pay standard variable tariffs (SVT) and default tariffs, and we recognise that the interests of customers as a whole are protected by regulating in a way that allows a notional efficient supplier to make a reasonable profit over time. However, there cannot be any guarantee that individual suppliers will always be profitable. In having regard to supplier financeability we look at a notional efficient supplier and for this policy change we have stress-tested this based on some of the variation we observe between real suppliers.
- 3.33 We have considered whether it would be necessary to provide a reconciliation mechanism to mitigate the impact of this reduction in allocation of charges to the standing charge on suppliers. As noted above, there is uncertainty on the extent to which supplier operating costs should be considered fully fixed costs and operating costs are a category within suppliers' control. We will consider the degree to which operating costs are fixed through the operating cost review, in the context of our assessment of notionally efficient costs. There are also issues when assessing average customer demand in that it will change from period to period and over time which would make designing an appropriate mechanism very challenging. We consider that changes within the range £20-100 could be absorbed without the need for a reconciliation mechanism but would welcome feedback from suppliers.
- 3.34 Our draft impact assessment in Appendix 2 sets out indicative analysis of the impacts on suppliers resulting from a £20 - £100 shift from standing charges to unit rates. We welcome views from stakeholders and consumers on what magnitude of operating costs shift they consider desirable within our stated range, and whether there are any additional changes required to enable this (within or outside of the price cap).

4. Increasing consumer choice through tariff diversification

This chapter considers how the diversity of standing charge and unit rate combinations across tariffs has changed over time and what, if any, interventions could result in consumers having access to a greater variety of tariff offerings.

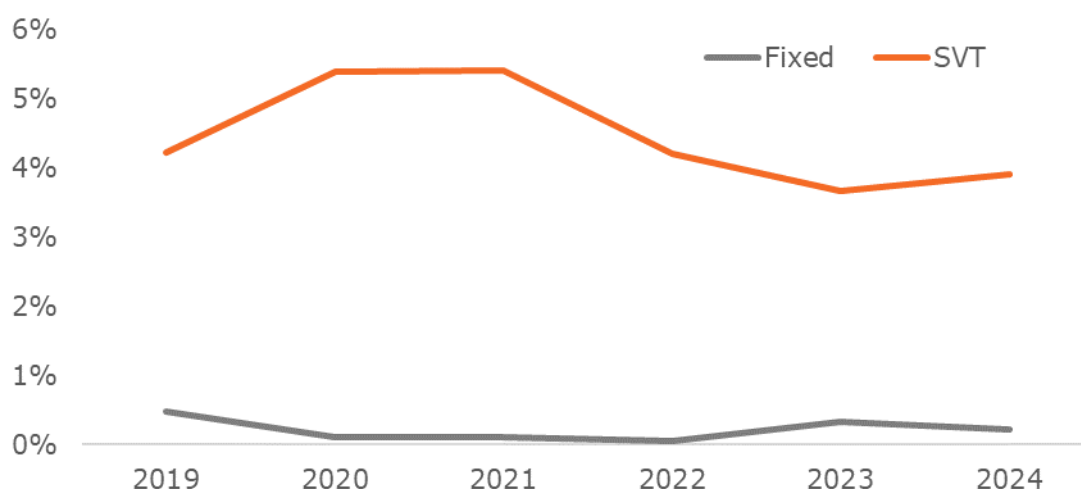
Questions

- Q5. Could mandating suppliers to have at least one low or no standing charge tariff available to customers help promote competition in this area of the market?
- Q6. How could we create flexibility in how costs are recovered between the unit rate and standing charge without reducing the protection provided by the cap?
- Q7. In enabling greater diversity in standing charges on default tariffs, what, if any, safeguards would be needed to protect vulnerable consumers?
- Q8. What are the key considerations we should take into account in developing options for smoothing spend for prepayment meter customers?

Context

4.1 The response to our call for input made it clear that many consumers would like to see greater variation in the standing charges offered by suppliers and, in particular, more tariffs with low or no-standing charges. Several such tariffs exist in the market, but despite this, the proportion of customers on no-standing charge tariffs has remained low over time – see Figure 4.1.

Figure 4.1 – Proportion of domestic customers on a zero standing charge tariff by tariff type

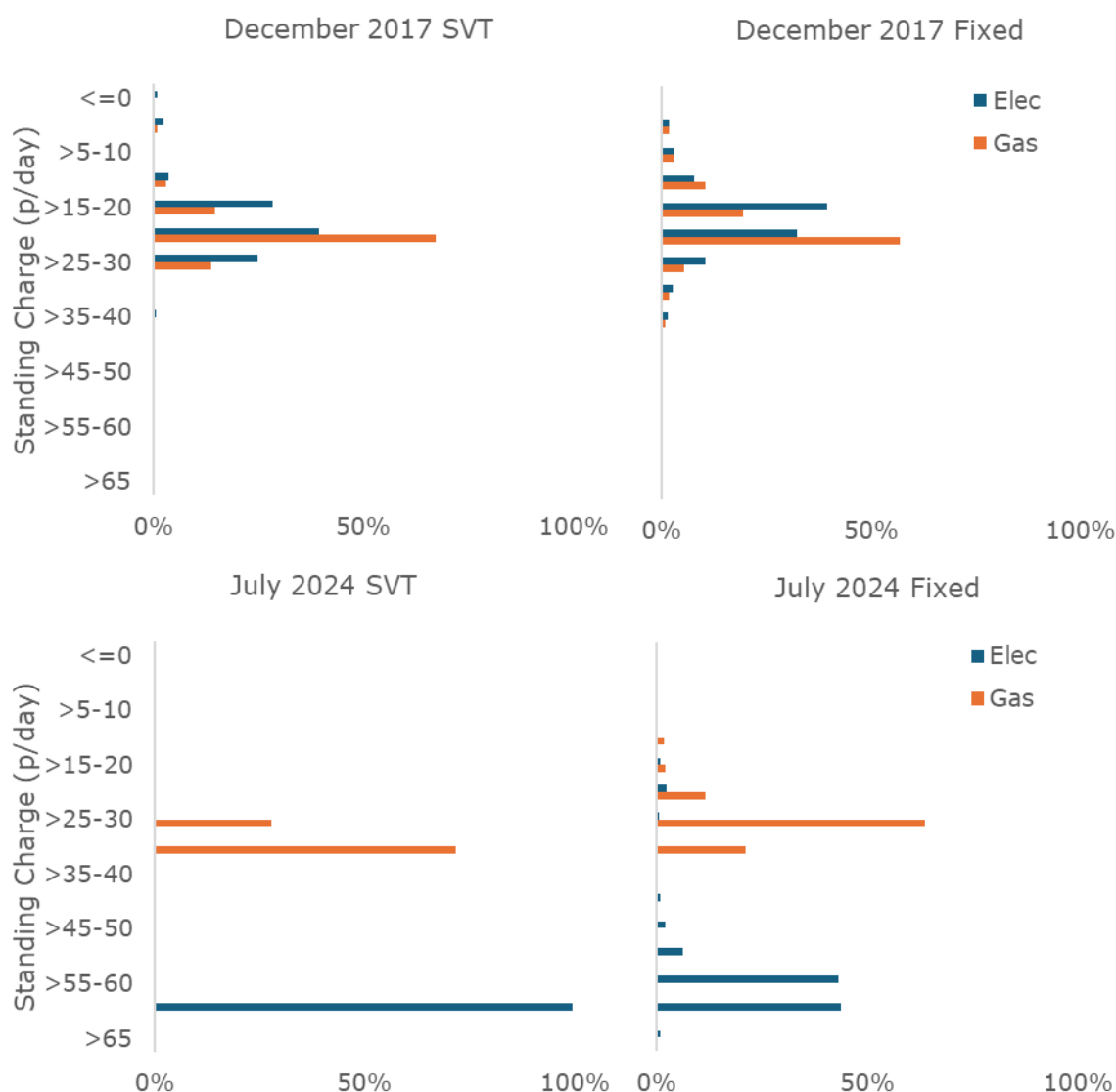


Source: Ofgem Tariff and Customer Account RFI

- 4.2 Some of the no-standing charge options include high priced first few units of energy, acting as an effective standing charge if any energy is used. For example, currently there are prepayment meter tariffs available with no standing charge but the first 2kWh of daily consumption recovers 99.5% of the maximum standing charge allowed in the price cap.
- 4.3 Most, but not all, tariffs with low standing charge are offset by higher unit rates. The lowest standing charge on a fixed proposition available in recent months (that does not require the purchase of additional service) offered a £100 reduction in the standing charge, relative to the price cap, and a slightly higher unit rate. This tariff offered a saving of £86 versus the cap at typical consumption but becomes more expensive overall if a consumer were to consume approximately three times typical domestic consumptions.
- 4.4 Currently, tariffs are available that track the price cap unit rate and provide a £50 per year discount against the current price cap standing charge. Many companies offer fixed tariffs with lower standing charges (and often higher unit rates), some with a reduction in the standing charge of up to £150 per year,¹⁸ but those with larger standing charge reductions (over £50 per year) tend to require the purchase of additional services.
- 4.5 Figure 4.2 shows how the diversity of standing charges observed across customers on variable tariffs, and to a slightly lesser extent fixed contracts, has declined drastically since the introduction of the default tariff cap ('the price cap'). The figure includes only direct debit tariff offerings (so does not include the zero standing charge tariffs available for prepayment meter customers discussed in paragraph 4.2).

¹⁸ Tariff offerings will vary regionally

Figure 4.2 – Proportion of customers by standing charge, fuel and tariff type in December 2017 and July 2024



Notes: Distribution of standing charges for direct debit customers in Merseyside and North Wales. Data from Ofgem RFIs.

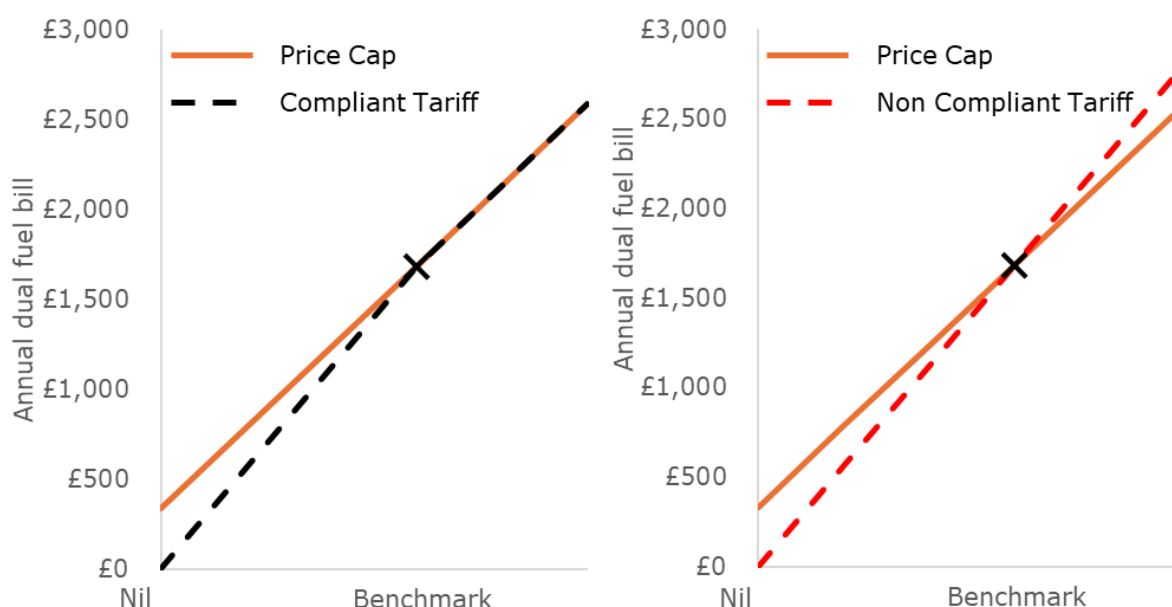
Alternate Format: Table of Values

Standing Charge (p/day)	Elec, SVT 2017	Gas SVT 2017	Elec Fixed 2017	Gas Fixed 2017	Elec, SVT 2024	Gas SVT 2024	Elec Fixed 2024	Gas Fixed 2024
<=0	1%	0%	0%	0%	0%	0%	0%	0%
>0-5	2%	1%	2%	2%	0%	0%	0%	0%
>5-10	0%	0%	3%	3%	0%	0%	0%	0%
>10-15	4%	3%	8%	11%	0%	0%	0%	2%
>15-20	28%	15%	40%	19%	0%	0%	1%	2%
>20-25	39%	67%	32%	57%	0%	0%	2%	11%
>25-30	25%	14%	11%	5%	0%	28%	0%	64%
>30-35	0%	0%	3%	2%	0%	72%	0%	21%

Standing Charge (p/day)	Elec, SVT 2017	Gas SVT 2017	Elec Fixed 2017	Gas Fixed 2017	Elec, SVT 2024	Gas SVT 2024	Elec Fixed 2024	Gas Fixed 2024
>35-40	0%	0%	2%	1%	0%	0%	0%	0%
>40-45	0%	0%	0%	0%	0%	0%	1%	0%
>45-50	0%	0%	0%	0%	0%	0%	2%	0%
>50-55	0%	0%	0%	0%	0%	0%	6%	0%
>55-60	0%	0%	0%	0%	0%	0%	43%	0%
>60-65	0%	0%	0%	0%	99%	0%	44%	0%
>65	0%	0%	0%	0%	0%	0%	1%	0%

4.6 The price cap limits suppliers' ability to pass fixed costs through on the unit rate on standard variable tariffs. For a tariff to be price cap compliant, it cannot result in total charges above the price cap maximum charge for any given level of consumption. Figure 4.3 provides an example of this

Figure 4.3 – Illustration of a compliant and non-compliant zero standing charge tariffs against price cap maximum charges (£/year dual fuel direct debit)



4.7 Tariffs with lower standing charges but with unit rates which result in total charges which sit at or below the price cap line at all consumption values are compliant (example given by the black dotted line). Tariffs of this nature are being offered by some suppliers currently. In contrast, tariffs with lower standing charges but higher unit rates which result in total charges above the price cap line at some levels of consumption (example given by red dotted line) would not automatically be compliant with supplier licence conditions.

- 4.8 There is currently one exception to this, set out in licence conditions 28AD.32 and 28AD.31 of the electricity and gas supply licences respectively. This exception allows suppliers to request a direction that their tariff is compliant with the price cap because customers subject to that tariff are unlikely to have consumption at levels that would cause them to incur charges that exceed the maximum price cap charge. If a consumer does exceed the maximum charge, the difference must be rebate/credited back to that consumer.
- 4.9 We recognise the limitations of our current approach. Ideally, suppliers would have freedom to decide how they recover their costs, particularly those costs that are within their control, such as operating costs. In doing so, we would expect them to adopt different commercial strategies resulting in a range of different standing charge offerings.
- 4.10 In practice, however, if we were to only set a cap at typical consumption, and therefore enable suppliers to recover costs between the standing charge and unit rate as they see fit, we expect they would optimise against their own customer base, resulting in consumer detriment. The same would be true if we were to set multiple caps with different standing charge/unit rate splits. Ultimately, to provide consumers with the level of protection that the cap as currently formulated affords, we must define a universal approach across all suppliers.

Case for change

- 4.11 The case to increase tariff diversity fundamentally centres on consumer choice and empowerment. Consumers have made it clear to us that they want to be able to make an active choice on what level of standing charge they pay.
- 4.12 Therefore, we consider that, first and foremost, we should consider what action we could take to generate the right market conditions and/or commercial incentives to drive more standing charge diversity in fixed term contracts, the sector of the market where consumers generally make the most active choices.
- 4.13 We do, however, recognise that standing charges offered in the fixed term market currently tend to group around those defined in the price cap (as evidenced in Figure 4.2) and that approximately 85% of the market is currently on SVTs (i.e. price cap tariffs). Therefore, we consider that there might be a case to explore options to increase standing charge diversity on SVTs. Further, there could be competition and market stability advantages in allowing suppliers

to choose how they recover their costs between the standing charge and unit rate on SVT tariffs.

- 4.14 Our early assessment of the options to increase standing charge diversity on SVT tariffs, however, is that they appear to require a fundamental change to how we set the price cap and would likely result in an overall reduction in protection for SVT customers. We welcome stakeholder views on whether increasing diversity in SVT standing charges would be beneficial for consumers, considering impacts on both high and low usage consumers, and if so, how we could do so without reducing total consumer protection.

Increasing tariff diversity in the fixed term contract market

- 4.15 There are no clear regulatory barriers for suppliers to offering low or no-standing charge fixed term tariffs. Despite this, as shown in Figure 4.1, we currently see very low numbers of customers on fixed tariffs with no-standing charges. As fixed tariffs are not subject to the price cap, Figure 4.2 does not show as dramatic a narrowing of standing charges as is present in SVTs, but there has been a clear reduction, with most customers paying standing charges within 5p of the price cap level. Interestingly, very few fixed rate customers are paying standing charges higher than the price cap level.
- 4.16 There are several forms that a low or no-standing charge fixed tariff could take. It could be a simple tariff with no standing charge and a single unit rate. Alternatively, our call for input referenced block tariffs, and some stakeholders expressed support for these. A rising (or falling) block tariff is a type of multi-tier tariff where customer's consumption is charged at progressively higher (or lower) unit rates for consumption in different tiers or blocks. This means the rate per unit of energy increases (or decreases) as the volume of consumption increases. This could allow suppliers to recover standing charge costs through a higher unit rate on certain units of energy instead of through daily charges.
- 4.17 The current limited availability of low or no-standing charge tariffs appears to indicate that such tariffs are less commercially viable for suppliers. However, some large suppliers currently offer lower standing charge tariffs.
- 4.18 Responses to our call for input indicate that the lack of such offers is likely to be caused by a combination of supplier risk aversion and adverse selection. If a supplier were to offer a tariff with no standing charge and a higher unit rate, they can expect customers who have low enough usage to benefit to apply. This

- causes them to set the unit rate a little higher to account for this, causing only even lower usage customers to apply, and so on until the tariff is unattractive for virtually all consumers.
- 4.19 It may also be that the lack of tariff diversity reflects low competition for such tariffs in the retail market. Suppliers may not feel pressure to offer no standing charge tariffs if they judge that their existing customers are unlikely to switch to another supplier as a result.
- 4.20 During the recent gas crisis, suppliers stopped offering competitive fixed term contracts. Switching, and arguably competition, reached an all-time low. We are beginning to see the recovery of the fixed term market. The lack of standing charge diversity may be a symptom of this broader environment.
- 4.21 An alternative, or complementary, driver of lack of competitive pressure to deliver tariffs with lower standing charges is that customers ultimately prioritise lower bills over the perceived advantages of lower standing charges.
- 4.22 The typical way tariffs are presented to customers, either directly by the supplier or through a price comparison website (PCW), is as an estimated monthly or annual bill. This presentation does not necessarily draw direct attention to the unit rate/standing charge split.
- 4.23 Evidence suggests that price is a key driver of customer choice. 40% of consumers surveyed in the Q4 Consumer Perceptions of the Energy Market survey, gave "To get a better tariff" as their reason for switching and 15% stated they switched "To get a fixed term deal" (down from 24% in Q3'22).¹⁹ To the extent that low standing charges are valued independently from their impact on the expected cost, the overall bill may still play a more important role in determining a customer's choice – at least for those actively selecting a tariff.
- 4.24 Whether the driver is demand or competition based (or most likely a combination of both), the fact that there was greater diversity of standing charges in the market before the cap was introduced may suggest there is potential for greater diversity without further regulation, and we are beginning to see signs of greater diversity.

¹⁹ Ofgem (2023), Consumer Perceptions of the Energy Market Q4 2022, <https://www.ofgem.gov.uk/publications/consumer-perceptions-energy-market-q4-2022>

- 4.25 We welcome and encourage suppliers to make more tariffs available with a range of standing charges. We consider it to be prudent to continue monitoring the fixed term market as competition recovers from the gas crisis and only consider further action on fixed term contracts should we not see the desired outcome of greater standing charge diversity materialise.
- 4.26 If we do not see diversity in standing charge tariffs increase, then we would consider mandating suppliers to offer a tariff option for both gas and electricity consumers that has either low or no standing charges. We welcome feedback on the following key considerations we would need to take into account:
- Mandating suppliers to offer low or no standing charge tariffs could increase the diversity in offerings available in the case that suppliers do not do so on their own. But suppliers could set the unit rates so high that the tariff would be unattractive for most consumers, meaning that there would be no real increase in tariff diversity, rendering the measure ineffective.
 - There is a risk that customers make choices that increase their bills. It is therefore crucial that advice and information on these tariffs are clear and transparent, and customers are aware of the impacts for them.
 - Consumers would be required to actively switch tariff, protecting disengaged consumers from this risk of being on a tariff inappropriate for them.

Options to increase tariff diversity in SVTs

- 4.27 As discussed in paragraphs 4.6 - 4.10, SVTs are subject to the price cap which sets the maximum amount suppliers can charge SVT customers at zero and typical domestic consumption. The combination of these two sets the maximum a supplier can charge a consumer at all consumption levels.
- 4.28 The requirement that SVT charging schedules do not result in total charges above the price cap maximum charge means that a variable tariff with a standing charge below the nil consumption cap but a higher unit rate than the one inferred by the price cap is unlikely to be compliant as is unlikely to result in charges below the cap at all consumption levels. Suppliers are, however, able to request a derogation on the basis that consumers on the tariff are unlikely to have consumption at levels that would cause them to incur charges that exceed the maximum price cap charge (with a rebate provided if a consumer does exceed the maximum charge).

- 4.29 In an effort not to unduly limit tariff innovation, we have taken a pragmatic approach to assessing the compliance of more complex SVTs, such as multi-rate tariffs. Where tariffs do not fit into our standard compliance assessment framework, we work with suppliers to understand the potential for customer detriment and subsequently take a proportional approach to compliance.
- 4.30 It is reasonable to conclude that the significant reduction in standing charge diversity among SVTs (shown in Figure 4.2) can be partially attributed to the impact the price cap has on suppliers' ability to trade-off between a low or no standing charge and a higher unit rate. In addition, the case-by-case approach taken to assess the compliance of tariffs with more complex and innovative charging schedules may also act as a barrier to SVT standing charge diversity.
- 4.31 The primary route we see available to increase the diversity in standing charges offered on SVTs is to move away from the current cap structure, where the maximum price is set by drawing a line between (and extrapolating beyond) nil consumption and TDVC, and instead setting the cap at a single value.
- 4.32 This would give suppliers greater flexibility to set different standing charge / unit rate combinations, all of which would be compliant with the cap, likely increasing the diversity of the standing charges offered. This could have a knock-on positive impact on supplier stability (as suppliers have greater control over how they recover their costs, allowing them to differentiate their offerings for their customer base) and competition (by increasing the number of factors that suppliers are able to compete on).
- 4.33 In practice, however, if we were to only set a cap at typical consumption, without additional protections, we would expect that suppliers would choose the compliant rates that allow them to recover the highest amount of money. This risk applies to default tariffs due to the relative disengagement of customers (and not fixed term contracts where there is more customer choice). Therefore, allowing suppliers greater flexibility over their default charging schedules would likely result in financial detriment to consumers. The same would be true if we were to set multiple caps with different standing charge/unit rate splits (but the same overall level at a given consumption value). We welcome stakeholder views on what additional consumer protections would be required to provide suppliers with greater flexibility and control over their cost recovery.
- 4.34 However, without suitable protections, it is likely that the detriment to default customers outweighs the benefit of increased choice for those customers that

want to be able to choose SVTs with lower standing charges, particularly as the diversity in available standing charges on fixed term contracts is increasing.

- 4.35 We welcome stakeholders' views on whether increasing the diversity in standing charges in SVTs is in consumers interest, and if so, how we could do so without eroding the level of protection offered by the price cap (by, for example, ensuring no suppliers consumer base is adversely affected overall, relative to the price cap). We are particularly interested in any options that give suppliers more flexibility in how they recover their efficient costs.
- 4.36 We have explored expanding the reasons for which a price cap derogation could be granted to include that the tariff would not result in a higher customer weighted average charge, allowing a broader range of standing charges on SVT tariff but with additional checks in place to protect against detriment to consumers a whole. We are assessing how and whether this could be done so as to be consistent with the DCTA which requires us to set one cap for all and we welcome stakeholder views.

Smoothing spend for pre-payment customers

- 4.37 An alternative change, which does not result in some customers paying more overall, but which could offer certain customers a better experience would be to alter the timing of the payment of standing charges.
- 4.38 For some PPM customers, standing charges can take up a large portion of credit top-ups. This can be particularly challenging in colder months when energy consumption for heating is higher or when a customer is getting back on supply after a period of self-disconnection and standing charges have built up.
- 4.39 Two varying suggestions have been put forward: first, that to help smooth overall bills for PPM customers, standing charges could be higher in the summer months and then lower in the winter months. This would dampen the effect of very significant differences in costs between months and have some similarities to the smoothness of DD customers' bills through the year.
- 4.40 Conversely, this could exacerbate challenges felt by some PMM customers. Respondents to our call for input on debt and affordability commented on how they cut back their use over summer, only to find when they next come to top up their meter, that their new credit is used up paying their accumulated standing charge. This is doubly difficult for those who are also paying off energy

debt and would be made worse by introducing higher standing charges in summer.

- 4.41 Further, if applied to standard variable tariffs (that necessarily have no exit fee), there is the potential that customers jump between tariffs seasonally to avoid paying higher summer charge while benefiting from the lower winter charge. This would result in a cost-recovery challenge across the market.
- 4.42 Another suggestion has been to allow standing charge debt or arrears to be paid off on a longer timescale so that PPM consumers can apply any top up to consumption immediately. This would prevent PPM customers, following a period when they were not using energy, from having a significant portion of new credit being allocated to accrued standing charges rather than electricity or gas use. Again, this could help some consumers smooth their payments and stay on supply by improving the amounts they can afford in any given period.
- 4.43 We welcome stakeholder views on the key considerations that we should take into account in developing options for smoothing spend for prepayment meter customers.

Non-domestic tariffs

- 4.44 Following our call for input, feedback also highlighted the difficulty non-domestic consumers had in understanding their bills, particularly considering how elements of consumers energy charges are displayed in non-domestic bills. Considering this, we have been working with stakeholders, including suppliers, trade organisations and customers, to develop improved billing transparency.
- 4.45 We have published a best practice guide that covers best practices and voluntary standards to improve billing transparency for non-domestic customers.²⁰ This shares the views of consumer groups on helpful billing practices and the benefits of transparency, identifying areas where consumers may benefit from additional information on and about their bills, and to contribute positively to ongoing work from suppliers to implement further transparency on bills. Alongside the guide, we have published a glossary of terms to help non-domestic customers better understand their bills.²¹

²⁰ Ofgem (2024), Non-domestic best practice guide on billing transparency,

<https://www.ofgem.gov.uk/publications/non-domestic-best-practice-guide-billing-transparency>

²¹ Ofgem (2024), Non-domestic glossary of terms https://www.ofgem.gov.uk/sites/default/files/2024-04/Non-Domestic_Glossary_of_Terms.xlsx

4.46 We continue to monitor stakeholder concerns in the non-domestic market, including those around standing charges. We know that a big issue many non-domestic customers face is the cost of their energy, with many stakeholders raising the issue of pricing as a top area of concern. If a non-domestic customer has not yet negotiated a contract but is using energy through deemed rates, we are holding suppliers to account where they do not follow our rules. For contracted prices in the non-domestic sector, we do not regulate the level and make up of rates. The level paid and what is included in a standing charge (if there is one) and a unit rate will often vary based on the nature of the customer's business and the pricing and risk approach of the supplier. But we do expect suppliers to be transparent with their customers about what charges include and to clearly explain changes so that customers can make informed decisions about which supplier they use.

Multi-rate meters

4.47 In response to our call for input, some consumers explained that they were being billed for two standing charges for one property, primarily where they are on tariffs with peak and off-peak rates to facilitate the use of storage heaters.

4.48 We have been looking into this issue and remind suppliers of the requirements set out in SLC 28, which offers protection to relevant 28AD customers²² by requiring that the aggregate amount of all charges for Supply Activities (unit rate(s) and standing charge(s)) does not exceed the Relevant Maximum Charge within each 28AD Charge Restriction Period. We would also remind suppliers of our expectation that any standing charge passed onto customers should not exceed the nil consumption costs as set out in the price cap, unless the supplier can and has demonstrated that no customer will be charged more than the Relevant Maximum Charge as a result. We monitor supplier tariff data closely, carrying out a series of regular and ad hoc checks, to ensure supplier compliance. We will take necessary action where we find customers have been overcharged.

²² The cap (including nil consumption) applies to a relevant '28AD customer' as defined in the Gas and Electricity supply licences, which is a derivation of 'domestic customer', which is a further derivation of 'customer'. Domestic Customer means a Customer supplied or requiring to be supplied with electricity or gas at Domestic Premises but excludes such Customer insofar as he is supplied or requires to be supplied at premises other than Domestic Premises; with 'Customer' being defined as any person supplied or requiring to be supplied with electricity or gas at any premises in Great Britain but does not include any Authorised Electricity of Gas Operator in its capacity as such.

5. Network and policy cost allocation

This chapter sets out our views on longer term standing charge reform.

Questions

Q9. Do you have any views on our considerations for the allocation of network and policy costs?

Context

- 5.1 Standing charges broadly consist of costs that are more efficient to pay on a fixed basis rather than per unit of energy consumed. The costs included in the standing charge (which are reflected in the nil consumption price cap level) include:
- Electricity network costs (including distribution, transmission and SoLR costs)
 - Operating costs (such as billing, metering etc)
 - Policy costs (the cost of government schemes such as WHD)
 - Other costs (such as VAT)
- 5.2 We have discussed our considerations on allocation of operating costs between the standing charge and unit rate in Chapter 3, which outlines options that would reduce standing charges for customers.
- 5.3 In addition, we are considering the allocation of both network and policy costs in this chapter. Overall, a net zero energy system is expected to be cheaper to run, and result in lower bills, but a higher proportion of that bill is likely to be made up of fixed costs. This is due to necessary investment into, for example, electricity infrastructure, with a significant expansion of the network planned and underway to connect the major growth in renewable generation. Absent intervention, a system with higher fixed costs (and lower wholesale and therefore variable costs) could lead to higher standing charges.
- 5.4 As a result, we are planning to review how network charges and broader system costs are allocated to understand whether we could make further changes that would benefit customers as a whole. This will involve balancing the interests of different stakeholders impacted by any shift of fixed to volumetric costs. Any change needs to:

- consider how different allocations of costs could lead to fairer outcomes for consumers
- be mindful of the ability for industry participants to recover their efficient costs
- consider the impact of these costs on price signals in the market, which was a key driver of our TCR decision in 2019
- ensure that underlying system costs are allocated as efficiently as possible to minimise additional system costs that could subsequently end up on bills

Targeted Charging Review (TCR) and network costs allocation

- 5.5 In our Targeted Charging Review (TCR) in 2019, we shifted the cost-recovery elements of the electricity network charges from unit rates onto the standing charge to ensure everyone was making a fair contribution to network costs. This was good for system efficiency and saved domestic customers overall, though led to an increase in many non-domestic energy bills. This change in the way costs are recovered has been a significant driver of recent increases in the standing charge and given the current level of investment, absent of any intervention, electricity network costs are likely to continue to be the primary driver of any further standing charge increases.
- 5.6 In the TCR decision, we considered whether fixed or volumetric charges for households performed better against the principles of reducing harmful distortions, fairness, and proportionality and practical considerations. We concluded that a single fixed charge struck the best balance, by minimising charge avoidance and balancing our various concerns with respect to distributional impacts.²³
- 5.7 Since the TCR, the level of network costs has increased compared to 2019 forecasts and the wider cost of living crisis has increased the severity of cost pressures on low-income households. As a result, the distributional impacts of the change are stronger; this combined with strong stakeholder feedback on reforms to standing charges, particularly in response to our standing charges call for input, justifies further consideration of the question of how we recover network costs from consumers.

²³ We set out our principles for the TCR in the following document: Ofgem (2018), Annex 1- Targeted Charging Review (TCR) Principles. https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/annex_1_-_tcr_principles.pdf

- 5.8 Going forward, we expect transmission network charges (specifically, Transmission Network Use of System (TNUoS) residual charges) to be an enduring issue, as transmission network costs are expected to keep increasing, and there are currently limited options for recovering these revenues other than end-user charges. DUoS²⁴ residual charges, the elements of distribution network charges that contribute to standing charges, are currently high across most regions. These high charges are not expected to continue in all areas into future years,²⁵ and are expected to return to more acceptable levels in most regions.²⁶ As a result, the level of DUoS residuals is not seen as an area of significant concern, though we recognise the level of regional variation in standing charges is an area of concern for some users. On balance, we believe there is merit in revisiting the question of how fixed network costs are shared across market participants.
- 5.9 Looking again at how electricity network costs are recovered provides an opportunity to consider options that may allow a larger reduction in standing charges in an enduring way. We will be undertaking a broad review of system costs, and will consider whether various cost recovery options, including those considered and ruled out in the TCR process, provide an improved means of recovering these costs.
- 5.10 We will also consider potential wider impacts, for example a shift of electricity network charges from standing charges to unit rates would benefit owners of solar panels but would increase the costs of running heat pumps and electric vehicles (EVs). We also note that (in a similar way to the options set out on the allocation of operating costs in Chapter 3), consumers that have higher than average consumption could be worse off, where increased unit rates increase their overall bills by an amount not offset by the standing charges reduction. However, we will assess the range of more progressive ways to recover network costs, such as varying standing charges or creating charging bands based on ability to pay.

²⁴ Distribution Use of System

²⁵ There are 14 different DNOs covering different regions of GB. They each have their own allowed revenues. Due to variation in allowed revenues and other system characteristics, as well as differences in the areas covered by each network, there are different levels of standing charge in each DNO area.

²⁶ 2024/25 saw high DUoS standing charges, mainly due to high allowed revenues. 2024/25 saw some one-off allowed revenue costs that are not expected to reoccur in later charging years. In addition, some changes to the charging models (models that produce unit-rate charges and standing charges) stemming from recent Access project reforms are likely to lead to lower standing charges.

- 5.11 Some groups of non-domestic consumers raised specific concerns about how changes to their standing charges following the TCR have impacted them. For example, non-domestic consumers with 'peaky' electricity use (high use for short periods of time) face higher fixed charges due to large capacity needs but use relatively small amounts of electricity overall in comparison to their capacity.
- 5.12 As a result, we are engaging with a number of industry code change proposals that consider some of these non-domestic concerns. Distribution Connection and Use of System (DCUSA) change proposal DCP412 is considering whether changes could be made to ensure charges for peaky sites are proportionate. We are also engaging in DCP420, a change proposal considering the impact of fixed charges on electric vehicle charging stations. In addition, Balancing and Settlement Code (BSC) change proposal P441 is looking at arrangements relating to "local balancing" and how this could consider the netting off of balancing charges where generation and demand are closely located.
- 5.13 We have noted feedback from non-domestic consumers that some TCR-related arrangements, such as the rules around changes to capacity bandings, are quite rigid. We welcome feedback on areas where users or industry participants feel improvements are possible, and on proposals for proportionate changes.
- 5.14 We also note that, currently, standing charges and unit rates vary dependent on region; these are driven through the regional variations in distribution network charges and reflect the cost to serve consumers in different regions. This is because consumers' residual distribution charge covers the costs of the specific Distribution Network Operator (DNO) that serves their area. The 14 DNOs around the country have different costs and structures, which leads to variation²⁷. In our consideration of how network costs are recovered, we could also explore these regional differences further and consider if there is a case to remove these. However, this would be considered in conjunction with broader work on the Review of Electricity Market Arrangements (REMA) to assess the case for any change proposals.

²⁷ High electricity distribution costs in the North Scotland DNO region are currently supported through the Assistance for Areas with High Electricity Distribution Costs (AAHEDC) scheme. This scheme makes a contribution to the allowed revenues of the relevant DNO, which is recovered through a charge on all suppliers.

Policy cost allocation

5.15 As noted above, some policy costs are currently allocated to the standing charge. We believe that government should consider how future policy costs are allocated, to ensure that the burden on bills, and especially standing charges, remains low. This could include looking at whether some policy costs would better be recovered through taxation, and if applied to bills, what the right balance is between electricity and gas. We will continue to work with government on this.

Longer term view

5.16 Our planned re-examination of network charges and the government's work on future policy costs will be part of a broader review of how system costs are recovered from all users. This includes policy, network, balancing costs, retail and wholesale market costs. As we move towards a net zero system, we expect that fixed costs in the energy system will increase, while variable costs are likely to fall. This raises important questions around both the efficiency and the fairness of the current model of energy pricing in GB.

5.17 We welcome views on our long-term approach to standing charge reform and thoughts on options that can be implemented such that consumer benefit is maximised while supplier instability and market distortions are minimised.

5.18 We will continue to work on our long-term approach to cost allocation, including with government, with a view to present options next year.

6. Conclusion and next steps

This chapter sets out the next steps for each of the standing charge policy options, alongside setting out interacting workstreams.

- 6.1 This options paper explores a range of policy options to reduce standing charges and increase the diversity in tariffs available to consumers. This chapter sets out the next steps for each area. These options should also be considered in the wider context of related retail pricing workstreams, particularly those that consider approaches to debt.

Standing charges options next steps

- 6.2 **Moving part of operating costs to the unit rate:** We are in the process of conducting a review into the operating cost allowances in the cap and published a consultation on the allowance in May 2024. This included setting allowances based on up-to-date information, and consideration of whether the current split between the unit rate and the standing charge is appropriate. We will come forward with proposals on moving some of the operating costs to the unit rate (including the option not to change our current allocation) through this review. We are currently aiming to implement any updates in April 2025.
- 6.3 **Encouraging tariff diversity:** We will continue to monitor the fixed term market and, should we deem it necessary, consult with stakeholders on options to improve tariff diversity in due course. In parallel, we will continue to develop options to encourage tariff diversity on variable tariffs through our approach to price cap compliance.
- 6.4 **Review of allocation of energy system costs:** We will carry out a broad review of how system costs are recovered from all users, including considering how network costs are recovered and working with government on the allocation of future policy costs. We will consider any policy changes that may be required as a result of the review, we will consult stakeholders in due course.

Interrelated workstreams

- 6.5 **Bad debt review:** In August 2023, we published a decision on introducing a specific allowance into the price cap for bad debt costs associated with Additional Support Credit (ASC). Then in February 2024, we published a decision on a temporary bad debt adjustment in the form of a float and true-up. Following the float, we aim to review the need for a true-up with possible

implementation in summer 2025. Additionally, we recently consulted on potentially extending the ASC allowance in the cap across next winter.²⁸

- 6.6 **Levelisation of debt-related costs between standard credit and direct debit:** In February 2024, we published our decision to introduce levelisation of prepayment meter and direct debit standing charges from 1 April 2024. We also set out that we would further consult on the levelisation of debt-related costs between standard credit and direct debit consumers, taking into account developments and wider policy considerations. The options outlined within this paper, and ongoing work with government, may impact the case for change for levelisation. As a result, we have decided to pause further development of levelisation of debt-related costs until there is further clarity on potential alternative policy options.
- 6.7 **Debt and Affordability:** In March 2024 we published our call for input on affordability and debt in the domestic retail market. As discussed in the case for change, standing charge reform has the potential to improve affordability for some customers while reducing it for others. Further, standing charge reform is unlikely to materially reduce the extraordinary levels of debt currently present in the domestic energy market. We aim to update stakeholders on potential measures to address the extraordinary debt levels that are currently impeding the proper functioning of the retail market, and on consumer standards relating to debt management this autumn.

²⁸ Ofgem (2024), ASC extension letter <https://www.ofgem.gov.uk/consultation/additional-support-credit-extension>

Appendix 1 – Summary of questions

- A2.1 Please provide answers to the questions below and provide any other comments that may be relevant. In all cases, please provide as much detail as possible to support your input.
- Q1. Do you have any views on our case for change?
- Q2. What are your views on the range (£20-£100) of operating costs we are considering shifting from standing charges to unit rates? Should it be higher? Within this range, is there a value you would favour and why?
- Q3. What are your views on the trade-offs and impacts we have identified for consumers and suppliers? Should any of these take more or less significance in our assessment, and are there any important impacts we have not considered?
- Q4. What are the changes required, if any, to the price cap to facilitate a reduction in the level of the operating costs charged through the standing charge?
- Q5. Could mandating suppliers to have at least one low or no standing charge tariff available to customers help promote competition in this area of the market?
- Q6. How could we create flexibility in how costs are recovered between the unit rate and standing charge without reducing the protection provided by the cap?
- Q7. In enabling greater diversity in standing charges on default tariffs, what, if any, safeguards would be needed to protect vulnerable consumers?
- Q8. What are the key considerations we should take into account in developing options for smoothing spend for prepayment meter customers?
- Q9. Do you have any views on our considerations for the allocation of network and policy costs?

Appendix 2 – Draft impact assessment of reducing standing charges in the default tariff cap

- A2.2 This Appendix sets out a draft Impact Assessment (IA) for transferring a portion of the operating cost allowance in the price cap from standing charges to unit rates. We welcome stakeholder feedback on our methodology and results.
- A2.3 All impacts are assessed against the current standing charges arrangements and the current price cap period 12b (1 July to 30 September 2024). We do however note that any proposed changes would likely be implemented from April 2025, at the earliest, and therefore the actual impacts will likely vary from those presented below.

Our approach to this draft IA is based on Ofgem’s current guidance on impact assessments²⁹. The draft IA is structured as follows:

- i. Scope and approach
- ii. Summary of findings
- iii. Impacts on consumers
- iv. Debt impacts
- v. Impacts on suppliers
- vi. Impacts on competition and innovation

Scope and approach

- A2.4 This draft IA sets out the impacts of moving a proportion of operating costs from the standing charges to unit rates on consumers and suppliers as well as an assessment of how this policy would affect competition in the market. In addition, we consider the impacts against Ofgem’s statutory duties.
- A2.5 All impacts are assessed based on price cap levels for period 12b (1 July to 30 September 2024). Table A1 below sets out the GB average effective unit rates and standing charges for this cap period.

²⁹ Ofgem (2020), Impact Assessment Guidance <https://www.ofgem.gov.uk/publications/impact-assessment-guidance>

Table A1: Cap period 12b unit rates and standing charges

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	22.36	21.59	23.54
Single Rate Electricity	Standing Charge (p/day)	60.12	60.12	65.93
Gas	Unit Rate (p/kWh)	5.48	5.26	5.77
Gas	Standing Charge (p/day)	31.41	31.41	35.24
Multi Register Electricity	Unit Rate (p/kWh)	20.96	20.37	22.06
Multi Register Electricity	Standing Charge (p/day)	60.31	60.31	65.89

A2.6 This draft IA has considered the range of options set out in chapter 3. We have presented a range of impacts resulting from a £20 - £100 shift in the operating costs allowance of the price cap from standing charge to the unit rate, but welcome stakeholder views on whether we should consider a greater range. We present impacts at £20, £40, £60, £80 and £100.

A2.7 As noted in chapter 3, the proportion of the overall standing charge that shifts to the gas and electricity unit rate would be 62:38, respectively. This reflects the current apportionment of standing charges operating costs between gas and electricity.

Summary of findings

A2.8 Moving a portion of operating costs within the price cap from standing charges to unit rates will result in a reduction in bills for some consumers and an increase in bills for others. Households with lower-than-average consumption will benefit from a reduction in standing charges whilst households with higher-than-average consumption will lose out due to the increase in unit rates.

A2.9 Our analysis indicates that between 11.5m and 12.2m customers would benefit from a standing charges reduction with between 14.8m and 15.5m customers losing out. This policy would result in some low-income households experiencing higher bills, however, we estimate that more low-income households would gain rather than lose out to this policy.

A2.10 Our analysis of the impact of the standing charges reduction on suppliers indicates that some suppliers may under-recover fixed costs where their customer base is lower consuming than average. We would expect to see an opposite effect where a supplier has a relatively higher-consuming customer

base. These effects are demonstrated below using hypothetical supplier scenarios. We have also considered the impact of these changes on actual suppliers and consider that, in isolation, this policy would not make suppliers who would otherwise be able to hit their capital floor unable to do so.

- A2.11 Our competition assessment finds that some consumers might not contribute an equal share towards fixed costs for some suppliers because of this policy change and this scenario may have a wider impact across competition, innovation and the energy transition.

Impact on consumers

- A2.12 This section sets out the impact on consumers of shifting a proportion of operating costs from standing charges to unit rates. It focuses on the direct impacts of our proposed options on SVT consumers and sets out our analysis of the distributional impacts on SVT consumers. We also set out the impacts on uncapped consumers.

Impacts on SVT consumers

- A2.13 Most consumers (c. 85%) in the GB energy market remain on SVT contracts and therefore fall under the protection of the price cap. Moving a portion of operating costs within the price cap from standing charges to unit rates will result in a reduction in bills for some consumers and an increase in bills for others. Households on SVTs with lower-than-average consumption will benefit from a reduction in standing charges whilst households on SVTs with higher-than-average consumption will lose out due to the increase in the unit rate. A theoretical consumer that uses exactly average consumption will incur no benefits/disbenefits from this policy.
- A2.14 For the purposes of this analysis, we have assumed that all households currently on SVTs stay on their current tariff. We do however recognise that this policy may provide an incentive for consumers to move away from SVTs and onto fixed tariffs if they would benefit from doing so.
- A2.15 The overarching effect of the change would be an increase in the unit rates under the price cap and a decrease in the level of standing charges. The larger the transfer from standing charges, the higher the resulting increase in unit rates will be. Tables A2 to A6 below set out the unit rates and standing charges under the price cap for different standing charges reduction scenarios. The change in unit rates and standing charges compared to the current 12b price cap are shown in brackets. Note these are calculated using 12b cap levels and presented as an average across all regions.

Table A2: Unit rates and standing charges post £20 transfer from standing charges to unit rates

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	22.61 (+0.25)	21.84 (+0.25)	23.78 (+0.24)
Single Rate Electricity	Standing Charge (p/day)	57.98 (-2.14)	57.98 (-2.14)	63.83 (-2.10)
Gas	Unit Rate (p/kWh)	5.58 (+0.10)	5.36 (+0.10)	5.87 (+0.10)
Gas	Standing Charge (p/day)	27.92 (-3.49)	27.92 (-3.49)	31.82 (-3.42)
Multi Register Electricity	Unit Rate (p/kWh)	21.14 (+0.18)	20.55 (+0.18)	22.24 (+0.18)
Multi Register Electricity	Standing Charge (p/day)	58.12 (-2.19)	58.12 (-2.19)	63.80 (-2.09)

Table A3: Unit rates and standing charges post £40 transfer from standing charges to unit rates

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	22.86 (+0.50)	22.08 (+0.49)	24.03 (+0.49)
Single Rate Electricity	Standing Charge (p/day)	55.89 (-4.23)	55.89 (-4.23)	61.74 (-4.19)
Gas	Unit Rate (p/kWh)	5.69 (+0.21)	5.47 (+0.21)	5.97 (+0.20)
Gas	Standing Charge (p/day)	24.49 (-6.92)	24.49 (-6.92)	28.40 (-6.84)
Multi Register Electricity	Unit Rate (p/kWh)	21.32 (+0.36)	20.73 (+0.36)	22.42 (+0.36)
Multi Register Electricity	Standing Charge (p/day)	56.03 (-4.28)	56.03 (-4.28)	61.71 (-4.18)

Table A4: Unit rates and standing charges post £60 transfer from standing charges to unit rates

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	23.10 (+0.74)	22.33 (+0.74)	24.28 (+0.74)
Single Rate Electricity	Standing Charge (p/day)	53.79 (-6.33)	53.79 (-6.33)	59.65 (-6.28)
Gas	Unit Rate (p/kWh)	5.79 (+0.31)	5.57 (+0.31)	6.08 (+0.31)
Gas	Standing Charge (p/day)	21.07 (-10.34)	21.07 (-10.34)	24.98 (-10.26)
Multi Register Electricity	Unit Rate (p/kWh)	21.50 (+0.54)	20.92 (+0.55)	22.60 (+0.54)
Multi Register Electricity	Standing Charge (p/day)	53.94 (-6.37)	53.94 (-6.37)	59.62 (-6.27)

Table A5: Unit rates and standing charges post £80 transfer from standing charges to unit rates

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	23.35 (+0.99)	22.58 (+0.99)	24.52 (+0.98)
Single Rate Electricity	Standing Charge (p/day)	51.70 (-8.42)	51.70 (-8.42)	57.56 (-8.37)
Gas	Unit Rate (p/kWh)	5.90 (+0.42)	5.68 (+0.42)	6.18 (+0.41)
Gas	Standing Charge (p/day)	17.65 (-13.76)	17.65 (-13.76)	21.56 (-13.68)
Multi Register Electricity	Unit Rate (p/kWh)	21.68 (+0.72)	21.10 (+0.72)	22.78 (+0.72)
Multi Register Electricity	Standing Charge (p/day)	51.85 (-8.46)	51.85 (-8.46)	57.53 (-8.36)

Table A6: Unit rates and standing charges post £100 transfer from standing charges to unit rates

Fuel Type	Charge Type	Direct Debit	Prepayment	Standard Credit
Single Rate Electricity	Unit Rate (p/kWh)	23.60 (+1.24)	22.82 (+1.23)	24.77 (+1.23)
Single Rate Electricity	Standing Charge (p/day)	49.60 (-10.52)	49.60 (-10.52)	55.47 (-10.46)
Gas	Unit Rate (p/kWh)	6.00 (+0.52)	5.78 (+0.52)	6.29 (+0.52)
Gas	Standing Charge (p/day)	14.22 (-17.19)	14.22 (-17.19)	18.14 (-17.10)
Multi Register Electricity	Unit Rate (p/kWh)	21.87 (+0.91)	21.28 (+0.91)	22.96 (+0.90)
Multi Register Electricity	Standing Charge (p/day)	49.76 (-10.55)	49.76 (-10.55)	55.45 (-10.44)

A2.16 To demonstrate how the impacts of the policy options vary across different types of customers we have set out 7 case studies below based on some typical customer types. Each case study sets out a particular customer type with different levels of consumption or characteristic (e.g. medically dependent), we have then estimated the impacts of shifting operating costs from standing charges to unit rates. The below table sets out the impacts based on an average DD, dual fuel bill using the 12b price cap figures.

Table A7: Impacts on consumer bills of moving a portion of the operating costs from standing charges to unit rates

Example consumer type	£20 shift	£40 shift	£60 shift	£80 shift	£100 shift
Two/three bedroom house with electric storage heaters (E7 or equivalent) occupied by a retired couple 12,500kWh elec only	£23	£46	£69	£93	£116
Three/four bedroom rural house with gas heating and poor energy efficiency occupied by a family with two children 30,000kWh gas, 3,000kWh elec	£18	£37	£55	£74	£92
Two/three bedroom house with gas heating occupied by a family, including one who has a disability requiring medical equipment and constant heating 25,000kWh gas, 4,000kWh elec	£15	£31	£47	£63	£78
Two bedroom flat with direct electric heating occupied by a family with a young child needing constant heating 10,000kWh elec only	£17	£34	£51	£68	£85
One bedroom flat with good energy efficiency and gas heating with a single occupant of working age 3,000kWh gas, 800kWh elec	-£15	-£31	-£46	-£61	-£76
One/Two bedroom flat with gas heating occupied by a couple of working age 4,500kWh gas, 1,100kWh elec	-£13	-£26	-£39	-£51	-£64
Two bedroom house/flat social housing with good energy efficiency occupied by a family with one child 7,500kWh gas, 1,800kWh elec	-£8	-£16	-£24	-£32	-£40

A2.17 The analysis in Table A7 demonstrates the point that households with lower-than-average consumption, such as small flats, will benefit from the transfer of operating costs from standing charges to unit rates. On the other side, households with higher-than-average consumption, such as those with primarily electric heating or those with poor energy efficiency, will see their bills increase because of the unit rate increase. These effects are exacerbated the higher the portion of operating costs shifted to unit rates.

A2.18 A customer's ability to change their consumption will also affect how these changes would affect their energy bill. For example, some customers may be able to more easily reduce their consumption following the implementation of

our policy and therefore higher consumption customers may not see the full negative impact at least in the short term. We do however acknowledge that many customers are not able to easily reduce their consumption and therefore will not be able to mitigate the impacts as easily.

Distributional impact on SVT customers

- A2.19 We have utilised Ofgem’s energy consumer archetypes to understand the impacts of this policy on different groups of consumers³⁰. The archetypes were designed to assist with the identification and understanding of different types of energy consumers, including those in vulnerable situations, and to model the impacts of future policy changes.
- A2.20 We have adjusted the average electricity and gas consumption for each archetype in line with 2022 consumption data. The adjusted consumption by archetype and decile feeds into future calculations.
- A2.21 Our modelling indicates that between c.11.5m and 12.2m households will be better off following shifting a portion of the operating costs from the standing charge to the unit rate. This is balanced against an estimated 15m households potentially worse-off as a result of the move. The magnitude of bill changes differs depending on the magnitude of the shift from standing charges to unit rates, the estimated overall average bill impacts are set out in table A8 below.

³⁰ The latest consumer archetypes can be found here: [Ofgem energy consumer archetypes update 2024](#)

Table A8 – number of households worse/ better off because of our proposed policy changes³¹

Scenario	Number of households worse off	Ave. bill increase per losing HH, £/year	No of households better off	Ave. bill reduction per gaining HH, £/year
£20 standing charge reduction	14.8m	£4	12.2	-£3
£40 standing charge reduction	15.5m	£8	11.5m	-£6
£60 standing charge reduction	15.5m	£12	11.5m	-£9
£80 standing charge reduction	15.5m	£17	11.5m	-£12
£100 standing charge reduction	15.5m	£21	11.5	-£15

A2.22 The consumer archetype framework uses ONS Living Cost and Food Survey data to assign each archetype and income distribution. From this, we can estimate how our policy will affect consumers at different income levels. The tables below set out our analysis of the number lower income households we expect to lose out from our analysis and how many we'd expect to gain from our analysis. For the purposes of our analysis here we have defined low-income as £19,500.³²

³¹ The number of households worse/ better off as a result of the standing charges transfer to the unit rates varies depending on the option. This is due to the impact of levelisation which can vary depending on the scenario. Note this effect is small and only affects households that are relatively close to average consumption.

³² We have calculated this based on median household disposable income (£32,300) in the UK for FYE 2022 as published by the Office for National Statistics. We have taken 60% of median income as our definition of low-income, in line with the ONS definition of the poverty line.

Table A9 – number of low-income households worse/ better off as a result of our proposed policy changes³³

Scenario	Number of low income households worse off	Ave. bill increase per losing HH, £/year	No of low income households better off	Ave. bill reduction per gaining HH, £/year
£20 standing charge reduction	2.3m	£4	3.8m	-£4
£40 standing charge reduction	2.4m	£7	3.7m	-£8
£60 standing charge reduction	2.4m	£11	3.7m	-£12
£80 standing charge reduction	2.4m	£14	3.7m	-£15
£100 standing charge reduction	2.4m	£18	3.7m	-£19

A2.23 As set out in Table A9 above, we estimate that our policy will result in a higher number of low-income households benefitting from the change to standing charges. We estimate that around 3.7m – 3.8m low-income customers would benefit from this policy with an average bill reduction of between £4 - £19. We estimate that around 58% of the low-income consumers that gain from this policy are currently in fuel poverty.³⁴

A2.24 We estimate that this policy would increase bills for around 2.3m-2.4m low-income consumers by between £4 - £18. There are a large number of consumers that would lose out by more than £30. We welcome stakeholder feedback to on how we could better understand these groups.

A2.25 We have also utilised the Ofgem consumer archetypes to understand the impact on households that are in receipt of disability benefits³⁵. Overall, we see a mixed picture across the archetypes that include households in receipt of disability benefits (A3, B5, D10 and E13). Using our definition of low income we find roughly even numbers of 'losers' and 'winners' resulting from a transfer of operating costs to standing charges, though slightly more low-income disabled customers are estimated to lose out. We estimate that the

³³ The number of low-income households worse/ better off as a result of the standing charge transfer to the unit rate varies depending on the option. This is due to the impact of levelisation which can vary depending on the scenario. Note this effect is small and only affects low-income households that are relatively close to average consumption.

³⁴ For the purposes of this analysis, we have defined fuel poverty a household that spends more than 10% of their net income on energy bills.

³⁵ Note this is the available definition within the consumer archetype framework, we'd welcome views from stakeholders on how we could refine this definition further.

average bill impact will be low to medium, with average annual bill increases of between +£5 to +£22, and bill reduction of between -£22 to -£4.

Income-weighted distributional analysis

- A2.26 In addition to our distributional analysis above, we have also considered the effects of the changes on an income-weighted basis. Income-weighted analysis considers how a £1 cost or saving has a different marginal utility depending on a household's income. In weighted analysis, financial benefits for low-income households are given a higher social value than the equivalent benefits for high-income households.
- A2.27 To assess the income-weighted distributional benefits, we have applied weights to each consumer archetype based on the disposable income deciles within each archetype, in line with the Green Book guidance published by HMT.³⁶ These income weights represent the assumption that low-income households will have a higher marginal utility for a pound saved compared to high-income households.
- A2.28 After applying the income weights, our analysis shows that low-income households (particularly Archetypes A1 – A3) realise the largest gains from standing charge reform. Higher income archetypes tend to see smaller income-weighted gains from this policy. Summing all the impacts across the consumer archetypes we find an annual net positive income-weighted saving to customers of c.£140m for our central £60 transfer scenario, implying that the changes would be more progressive than the status quo.

Impacts on consumers on uncapped contracts

- A2.29 Moving a portion of the operating costs from standing charges to unit rates will only directly impact those consumers on capped contracts (i.e. SVT consumers). We have however observed that the cap acts to influence fixed term contracts and therefore we may expect FTC consumers to experience similar effects to those on capped contracts.

Debt impacts

- A2.30 We have also considered the impact of moving a portion of operating costs from standing charges to unit rates on consumer debt volumes by assessing the impact changing consumer bills may have on existing consumer debt, by

³⁶ See annex 3 of HM Treasury (2022), The Green Book, <https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government/the-green-book-2020>

payment method. We define debt as money owed, with or without a repayment plan, for greater than 91 days.

- A2.31 Whilst the evidence shows that a proportion of consumers will benefit, there will unlikely be a significant change in the level of debt and arrears within the energy market given the relatively low average impact. There is also the likelihood that those consumers who do not benefit from the proposed change, those with higher-than-average consumption, low income, and debt on their energy account, may experience increased difficulty in reducing their debt level. This is a result of the higher energy bill that would result for those consumers due to higher unit rates compared to current ones.

Impacts on suppliers

Direct impact on suppliers

- A2.32 We have assessed the impact of this policy on both actual suppliers and a range of notional suppliers to determine the impact of fixed cost under- or over-recovery on a notional EBIT (earnings before interest and tax) allowance. We have used our stress testing assessments as a baseline to assess the impact of this policy on actual suppliers. We consider that, in isolation, this policy would not make suppliers who would otherwise be able to hit their capital floor unable to do so.
- A2.33 With regards to Market Stability Impact, suppliers have significantly different consumer bases with different consumption levels. Where suppliers have a larger proportion of higher-than-average consumers they may see over-recovery of fixed costs. Conversely, suppliers with a larger proportion of lower-than-average consumption than average may see under-recovery of fixed costs.
- A2.34 With regards to the materiality, the profitability impact for the notional supplier varies depending on consumer base, from being negative, when the proportion of the lower-than-average consumers is high, to positive, when the proportion of higher-than-average consumers is high.
- A2.35 With regards to Capital Adequacy, any change in recovery of fixed operating costs may affect profitability. This in turn could affect ongoing viability, including a supplier's ability to reach the Capital floor (£0 in adjusted net assets per dual fuel consumer) and the Capital target (£115/consumer).

Notional supplier analysis

- A2.36 We have modelled the approximate impact of this policy on a range of notional suppliers. We have assessed scenarios including where a supplier has a consumer base with lower-than-industry average consumption and suppliers with higher-than-industry average consumption. Overall, we find that the greater the amount shifted to unit rates, the greater the impacts on suppliers who have a significant proportion of consumers with above or below average consumption levels.
- A2.37 Our notional supplier analysis creates three hypothetical suppliers. Each has a consistent percentage split of payment methods across customer accounts³⁷, and each with the same number of customer accounts for both gas and electricity (1 million accounts). Consumption has been used as the variable factor (whilst customer account numbers and payment method split have remained static), as this element is the main driver of difference between suppliers under this policy. We have based our assumptions around the average consumption of each notional supplier on a range of 'actual' consumption reported by suppliers. Supplier A represents a supplier with low average demand, Supplier B has a customer base with industry mean demand, and Supplier C has a customer base with high average demand. The consumption values used are set out in Table A10 below.
- A2.38 We have chosen these values as they represent actual historic industry demand, with the "low" and "high" consumption based on the lowest and highest supplier average consumptions across major suppliers in this period.

Table A10 – Assumed consumption for hypothetical suppliers

Hypothetical supplier	Assumed electricity consumption (single) (KWh)	Assumed gas consumption (KWh)
Supplier A	2,736	8,424
Supplier B	3,003	10,880
Supplier C	3,653	13,369

- A2.39 In addition to the above scenarios, we have tested the sensitivity of our analysis by varying consumption by +/- 10%. This was done to reflect impact changes for each scenario at higher or lower consumption, rather than reflecting a natural loss or gain of revenue a supplier may experience with consumption change, regardless of operating costs transfer.

³⁷ This split is based on the average proportions of the payment methods in the industry.

A2.40 Tables A11 – A13 below show estimates of what a notional supplier’s EBIT (expressed as a percentage of revenue) would be across the standing charge operating costs shift options we are considering as a result of under- or over-recovery of fixed costs.

Table A11 – EBIT as a proportion of revenue at average demand

Average	Baseline	£20	£40	£60	£80	£100
Supplier A	2.6%	2.2%	1.9%	1.6%	1.2%	0.9%
Supplier B	2.6%	2.5%	2.4%	2.3%	2.2%	2.1%
Supplier C	2.6%	2.7%	2.8%	3.0%	3.1%	3.3%

Table A12 – EBIT as a proportion of revenue at +10% demand

+10%	Baseline	£20	£40	£60	£80	£100
Supplier A	2.6%	2.3%	2.1%	1.9%	1.7%	1.5%
Supplier B	2.6%	2.6%	2.6%	2.6%	2.6%	2.7%
Supplier C	2.6%	2.8%	3.0%	3.3%	3.5%	3.8%

Table A13 – EBIT as a proportion of revenue at -10% demand

-10%	Baseline	£20	£40	£60	£80	£100
Supplier A	2.6%	2.1%	1.6%	1.1%	0.6%	0.1%
Supplier B	2.6%	2.3%	2.1%	1.9%	1.7%	1.4%
Supplier C	2.6%	2.6%	2.6%	2.6%	2.7%	2.7%

A2.41 Using industry average demand (low to high as displayed in Table A10), we see EBIT as a proportion of total revenue fall for Supplier A (low consumption) and Supplier B (medium consumption) in line with an increasing value transferred to the unit rates. Supplier C, with a high average consumption base, sees its EBIT proportion rise as the value of operating costs transferred to the unit rates increases.

A2.42 However, it should be noted that even at baseline, the notional suppliers have differing proportions of EBIT beyond one decimal place. This is a result of their different consumption levels. The baseline EBIT (and following scenario) proportions are also influenced in part by the split of customers between payment methods, as EBIT allowance varies between these. More broadly, we anticipate, like EBIT, that other cap allowances which are calculated as a percentage of certain categories within the unit rates or standing charges may be impacted by this policy (for example, the Headroom Adjustment Percentage - HAP).

A2.43 Overall, our notional supplier analysis suggests that suppliers with lower mean consumption would incur the greatest under-recovery of fixed costs, with this under-recovery growing as the value of operating costs transferred to unit rates increases. Likewise, suppliers with higher mean consumption see

an over-recovery of fixed costs, with this inflating as the value of operating costs transferred to unit rates increases.

A2.44 We consider that this range may be reasonable for suppliers to absorb without mitigation, as it takes no regard of suppliers' ability to control these fixed costs. To the extent that mitigation may be required, we will consider this in the round when making future benchmarking decisions in the operating costs review.

A2.45 To conclude, our assessment of the impact on suppliers from shifting a portion of operating costs from standing charges to unit rates:

- Higher consumption consumers may result in over-recovery of fixed cost for suppliers and vice versa for lower consumption consumers.
- Potential under-recovery of costs from low consumption consumers

Impact on competition and innovation

A2.46 Using Ofgem's Competition Framework, we have conducted an initial assessment on the impact on competition. We have looked at whether and how such changes may affect the underlying features of the market; namely, (i) customer engagement and empowerment, (ii) market rivalry and (iii) market entry/exit.

Consumer engagement and empowerment

A2.47 The changes are intended to improve consumers' ability to control their energy bills and thereby to strengthen engagement in the retail energy market. However, the proposed range is for a reduction of up to 30% in the standing charges, i.e. most standing charges would remain. Hence, it is not clear whether the potential changes would lead to significant improvement in engagement.

A2.48 We do not think the potential standing charges reduction would impact customers' ability to switch. Given standing charges overall would remain, the reduction does not necessarily make it easier for customers to compare alternatives. In fact, tariff comparisons may become more complicated over time anyway (e.g. due to Market Half-Hourly Settlement), so there may be limited value in simplifying one component in isolation.

A2.49 Finally, increasing the unit rates could create a stronger incentive for consumers to reduce their consumption. Historically, domestic energy demand has been relatively inelastic, but responses to our call for input provided substantial evidence that recent cost of living issues have led many

consumers to seek ways to minimise their costs by reducing consumption. Reducing standing charges would give these consumers more direct control over their expenditure, however this may not benefit consumers who are already self-rationing or may end up further self-rationing.

Market rivalry

Supplier profitability

A2.50 As we set out above, the changes would impact suppliers' profitability differently based on the average consumption of their consumer base. This in turn will improve the competitive position of some suppliers while weakening others. We expect suppliers with a large proportion of lower-than-average consumption users to have less flexibility in pricing, which may impact their ability to win new customers. Prepayment meter consumers generally have lower-than-average consumption, and we will consider the impact on them in the round as part of the payment type analysis within our ongoing operating costs review.

A2.51 The impact on suppliers' profitability depends on variations in operating costs: efficient suppliers will still be able to serve all consumers profitably, while those with average or below average efficiency will see some lower consumption segments contribute less than their equal share of fixed costs. The interaction between the changes and efficiency incentives in the cap will also be considered as part of our operating costs review.

Product offerings

A2.52 As noted in chapter 2, we expect the changes to affect other tariffs offered by suppliers. On the one hand, suppliers tend to use the price cap standing charge as a benchmark for their fixed tariff offerings,³⁸ so it is likely that they will revise their main fixed tariffs to reflect the new balance between standing charges and unit rates. On the other hand, suppliers will have a stronger incentive to acquire high consumption consumers, which could encourage them to offer new products to target this segment, such as falling block tariffs (offering lower unit rates on higher consumption levels), or tariffs targeted towards high consumption consumers. However, our analysis above indicates that the maximum additional discounts that could be offered through these tariffs is unlikely to be high enough to win significant numbers

³⁸ As of 15/07/2024, almost 60% of fixed tariffs on offer had a standing charge that was less than 1p/day different from the price cap.

of new consumers, which makes it less likely that suppliers will have sufficient incentives to develop whole new tariff categories. Suppliers may instead continue to offer some tariffs based on the current balance between standing charges and unit rates, which will be cheaper for high consumption consumers.

A2.53 Different considerations can be drawn for EV tariffs. Since EV consumers are likely to have high consumption, and EV-specific tariffs are already a distinct product category, suppliers will have an incentive to focus their product development and marketing on this segment of the market. This could, however, favour suppliers that already have a strong position in the EV segment.

A2.54 The changes are likely to further strengthen suppliers' incentive to increase the consumption of their consumers. However, suppliers already have these incentives, and it is not clear whether the effect of the changes will be strong enough to affect supplier behaviour. It may be more likely that suppliers will reduce efforts to help consumers decrease consumption rather than actively take steps to encourage an increase.

Service levels

A2.55 Suppliers whose ability to recover fixed costs reduces because of the proposed changes may look to reduce their operating costs. For these suppliers, the operating costs reduction is likely to negatively affect the service levels offered to their consumers. However, the negative effect on suppliers' incentives would be mitigated by:

- (i) the risk of losing consumers to suppliers offering better service, and
- (ii) our Consumer Standards backed by licence conditions.

A2.56 We would expect that any impact on service standards would affect all of a supplier's customers: suppliers cannot actively discriminate against less profitable consumers, as it would be in breach of the principles of fairness set out in our Standards of Conduct.

Market entry/exit

A2.57 On the one hand, the creation of consumers who contribute less to fixed costs, and the Universal Service Obligation (USO) – which requires suppliers to offer any domestic customers terms to enter a contract - may disincentivise new suppliers to enter the market, particularly those focusing on more innovative tariffs, who have already identified the USO as a barrier

to entry. On the other hand, new entrants are typically more efficient than incumbents, and, thus, they may be at less risk of not being able to cover their costs. In addition, their customers will generally not be on default tariffs (given they have made an active choice to switch). Based on our analysis on the impact of the changes on suppliers' profitability and financial resilience, we consider that efficient suppliers should continue to be able to earn a reasonable return.

- A2.58 Finally, the changes may negatively affect how existing and potential suppliers' view the market, as the changes may increase suppliers' risk by creating a discrepancy between the structures of the costs they face, and the revenues they can earn under the price cap.

Risks, assumptions, and limitations

Risks

- A2.59 The consumer impacts calculated in this draft IA will vary based on actual consumption values.

Limitations

- A2.60 The distributional and vulnerability data we have used as part of this draft IA does not give a complete picture across the population. We have not been able to interrogate vulnerability characteristics in isolation. Therefore, this does not allow for a holistic assessment of the impacts of moving a portion of operating costs from standing charges to unit rates on the vulnerable population.
- A2.61 In order to generate benefits for consumers and suppliers, Ofgem would like to explore the case for receiving more granular data from suppliers on a regular basis. In order to understand the capacity for more granular information to be supplied to Ofgem from suppliers, we would want to discuss how best to co-design such an approach to minimise challenges for suppliers. Ofgem believes that with access to more granular data, it could allow for simplified requests for data from suppliers, which in time might allow existing RFIs to be aggregated and harmonised, ultimately reducing the reporting burden on suppliers.
- A2.62 Collecting more granular data would enhance the scope for more detailed analysis to be undertaken by Ofgem to better understand the impact of costs and policies on consumers, suppliers, and competition. Allowing us to better understand consumption, energy efficiency, household type, and socio-

economic indicator. This would better enable Ofgem to develop more targeted interventions, such as supports for particular groups of customers, be that from low-income areas, vulnerability, and/or affordability.

Wider impacts

Impact on inflation

A2.63 The expectation from this proposed change to the structure of the price cap is that it is a zero-sum impact on total costs faced by consumers so should have a negligible, if any, impact on inflation.

Environmental impact

A2.64 Lower overall consumption levels may result at an aggregate level, which may have a positive environmental impact, as well as an increased attractiveness of EV consumers (due to their higher consumption), which could lead to suppliers developing new options to target these households.

Supplier resilience

A2.65 As discussed, there is likely an impact on suppliers based on their consumer base being lower-than-average consumers versus higher-than-average consumers.

Public spend

A2.66 We are required to exercise our functions under the Domestic Gas and Electricity (Tariff Cap) Act 2018 with a primary focus on protecting consumers on default tariffs, while having regard to specified considerations (see s. 1(6) of that Act). Following the introduction of the Energy Prices Act 2022, those specified considerations include 'the need to set the cap at a level that takes account of the impact of the cap on public spending'. We have assessed the impact to this as nil.

Public sector equality duty (Equalities Act 2010)

A2.67 Ofgem is subject to the Public Sector Equality Duty (PSED) so in exercising our functions we must have regard to the need to:

- i) Eliminate discrimination, harassment, victimisation, and any other conduct that is prohibited by or under the Equalities Act 2010;
- ii) Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it
- iii) Foster good relations between persons who share a relevant protected characteristic and persons who do not share it

- A2.68 Our assessment is that the proposed changes on people with a protected characteristics overlaps with the PSED for the following portrayed characteristics: age and disability. Our assessment of benefits identifies the impact of our policy on these groups with the assumption that these groups (such as households with retirees, families with young children, and/or certain disabilities) will have higher than average consumption and therefore experience higher gas and electricity bills from the changes, see analysis set out in paragraph A2.26. As stated in Chapter 2, we make the case to continue to protect customers by working with government on longer term options to introduce further changes that will deliver positive outcomes for consumers.
- A2.69 For other protected characteristics such as race, religion, or sexual orientation, we have not identified any potential for discrimination or adverse impacts.

Appendix 3 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

Ofgem may share your personal data with DESNZ as part of our efforts to work together on retail pricing.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data.
- access your personal data.
- have personal data corrected if it is inaccurate or incomplete.
- ask us to delete personal data when we no longer need it.
- ask us to restrict how we process your data.
- get your data from us and re-use it across other services.

- object to certain ways we use your data.
- be safeguarded against risks where decisions based on your data are taken entirely automatically.
- tell us if we can share your information with 3rd parties.
- tell us your preferred frequency, content and format of our communications with you.
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".